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Editorial Comment

Canada's Part in the War

Two great peace-loving and freedom-loving nations of Europe have found themselves forced by the laws of humanity and righteousness to halt the insane ambitions of a cruel and bloodthirsty tyrant. During the past two months one man in Europe has encouraged the butchery of thousands of innocent men, women and children in Poland for no other reason than that they chose to guard their homes, their loved ones and everything they held dear, from the murderous attacks of his barbarous hordes. How long the struggle will last before the atrocities of Hitlerism in Europe are stopped no one can prophesy. Great Britain and France expect that their stand against such barbarism will extend over a period of at least three years and are making plans accordingly. The only reward looked for by these nations is the establishment of the freedom of the individual and of righteousness so that the peoples of the earth may dwell together in unity.

It has been said that a country's power to produce the sinews of war ranks high among the decisive factors in a major struggle. Not Great Britain and France alone, but

the British Empire as a whole has declared war on German atrocities, and the contribution that Canada is in a position to make at this time towards the common goal is regarded by the allies as one of great significance.

What exactly can that contribution be? Primarily Canada will, as in the war of twenty-five years ago, play the part of emergency food provider. During the past quarter century the population of the Dominion has not greatly increased, but the wheat acreage today is more than double that of the days of the Great War. This country will be able to export about eighty per cent. of the wheat raised, and this season's crop, the heaviest since 1932, is estimated to be well over 400 million bushels. Threshing returns, moreover, show this year's grain to be of high grade and excellent quality. Canada has been appropriately termed, then, the granary of the Empire.*

Mineral and Oil Resources

The successful prosecution of any war also depends to a very great degree on an ample supply of minerals. The unprecedented expansion of the mining industry of this Dominion in recent years means that Canada can now supplement her traditional role of Empire granary with that of Empire arsenal. It is noteworthy that, since the signing of the armistice in 1918, the annual value of minerals produced here has more than doubled. This country produces 87 per cent. of the world's supply of nickel, a mineral in unusual demand during war times. The further fact that the iron and steel industry of Canada is equipped under peace-time demand to produce 1,500,000 tons of pig iron annually—an increase of 50 per cent. over that of the last war years—will help to explain the decision of Great Britain, Canada, Australia and New Zealand to join in an immense co-operative effort to manufacture long-range bombers and to train aviators in this country. Added to all this is the geographical position of Canada. *The Economist* (London) makes the observation that planes manufactured here can be flown to England without extra fuel tanks, and in their passage will not come near any

*Agriculture and wheat are topics of importance to Canadians today. We are pleased, then, to be able to publish in this issue some observations of Professors R. McQueen and H. C. Grant of the University of Manitoba on these subjects.

foreign country and will be remote from any likely theatre of war.

An account of these resources for a war emergency would not be complete without some reference to oil production in the Dominion. According to the 1939 issue of *The Canada Year Book,* the developments which have taken place in the Turner Valley field in Alberta appear to forecast a major oil field, the potentialities and probable life of which are by no means yet determined. In the opinion of experts of the Dominion Geographical Survey Department another field of crude oil in addition to that of Turner Valley will be found in Alberta before long, and instead of a mere strip of twenty-five miles which comprises the Turner Valley, there will be an area of 100,000 square miles in that province favourable for oil development. As an indication of the progress in this direction since the last war, statistics show that the oil produced in Canada in 1914 was 214,000 barrels, valued at $343,000 and that in the year 1938 production had reached 7,000,000 barrels, valued at $11,800,000.

Income Tax Administration

In our issue of last March we referred briefly to that interesting book by Lord Hewart, Lord Chief Justice of England, *The New Despotism.* It is one which all of us, and we think the members of Parliament in particular, should read for enlightenment and digest with profit. So many of the observations of this great jurist can be applied to the administration of income tax acts in Canada that we should like to quote them all, but space permits reference to only a few.

The practical application of income tax legislation has assumed so large a part in the professional work of our members that the administration of the *Income War Tax Act* naturally invites comment at every annual meeting of the Dominion Association. At this year's convention in Saskatoon, the members from East and West did more than comment, however; they did not hesitate to give utterance to their criticisms of the present administration of income tax in Canada. The basis of their complaints was twofold—the unreasonable delays of the Federal department in completing corporation assessments (in some cases extending into two years) and the departmental policy

of secrecy surrounding the decisions or rulings of the commissioner.

To understand the reason for such criticism, it is only necessary for the reader to examine any of the Dominion and Provincial taxing statutes of today. In recent years there has been a pernicious influence at work which by degrees is undermining our whole system of democratic government and depriving citizens of long established rights for which their ancestors fought and died. The filching of these rights in this subtle way is something of which most citizens are not aware. Attribute it if you will to the ignorance or listlessness of the average legislator or to the overweening desire of departments of government to clothe themselves with a power that is free from the restraining influences of the courts, the fact is that there has been an unmistakable tendency on the part of parliament to permit the passage of statutes which vest in public officials, to the exclusion of the jurisdiction of the courts of law, the power of deciding questions of a judicial nature. Such power, as a rule, is given to a minister or other head of a government department, and the Act conferring such power provides that the decision of such official shall be final or conclusive.

In Discretion of the Minister

To the average legislator such expressions as "in the discretion of the minister" and "unless the minister is satisfied," which occur so often for instance in the *Income War Tax Act*, sound harmless; their free interspersion throughout the Act does not suggest to him anything prejudicial to the rights of the taxpayer. What he fails to recognize is that when the Act provides for a matter to be decided by the minister it really means, as Lord Hewart points out, that it is to be decided by some official in the department who has no responsibility whatsoever except to his official superiors. Often as not the minister does not hear of the matter or the decision, and the individual making such decision is not bound by any particular course of procedure or to receive any evidence before coming to a conclusion. "Even if such official acts in good faith and does his best to come to a right decision, he cannot" observes Lord Hewart, "help bringing what may be called an official or departmental mind, as everybody

who has had any dealings with public officials knows, to bear on the matter he has to decide . . . His position makes it inevitable that he should be subject to political influences."

Delays in Assessments

One of the criticisms advanced at this year's meeting was the delay of the income tax department in making corporation assessments. In this issue are reported two recent court judgments in respect of the *Income War Tax Act*, and the circumstances in one of these reveal how delays can work to the disadvantage of the taxpayer by making it impossible for him to complete his returns in subsequent years. The following statement of Mr. Justice Angers in the *Julius Kayser & Company* case illustrates, better than any comment of ours, the tardiness of the income tax department concerning which auditors and corporation executives have some cause for complaint.

> The return, which is for the fiscal year ending June 30, 1935, is dated October 30, 1935, and was presumably delivered to the Minister on that date.
>
> A notice of assessment, altering the amount of the tax as aforesaid, was sent to the appellant on October 30, 1936.
>
> Within the delay mentioned in section 58 of the Act, namely on November 27, 1936, the taxpayer served a notice of appeal upon the Minister.
>
> On July 26, 1937, the Minister rendered his decision affirming the assessment and notified the appellant accordingly.
>
> Within one month from the date of the mailing of the Minister's decision, to wit on August 23, 1937, the appellant sent to the Minister a notice of dissatisfaction in compliance with section 60 of the Act.
>
> On November 16, 1937, the Minister replied in conformity with section 62, denying the allegations contained in the notice of appeal and the notice of dissatisfaction and confirming the assessment.

Over two years in arriving at this point! But that was not the only delay. Not until 29th September 1939—three years and eleven months after the taxpayer had filed his return—was the decision of the Exchequer Court given and the taxpayer (provided he was satisfied with the court's

judgment) in a position to complete the returns for the years ending 30th June 1936, 1937, 1938 and 1939.

Departmental Rulings Kept Secret

Another criticism levelled against those responsible for the administration of the Federal income tax act was the action of the department in refusing to allow any of its rulings or decisions to become public. "This departmental policy of secrecy," states Lord Hewart, "is in itself sufficient to condemn the system under which the public departments act as tribunals to decide disputes of a judicial nature. This secrecy naturally leads to the conclusion that the departments are afraid of their proceedings being made public, and tends to destroy all confidence in the fairness of their decisions. How is it to be expected that a party against whom a decision has been given in a hole-and-corner fashion, and without any grounds being specified, should believe that he has had justice, and even the party in whose favour a dispute is decided must, in such circumstances, be tempted to look upon the result as a mere piece of luck . . . A department tribunal is, however, in no way bound, as a Court of Law is, to act in conformity with previous decisions, and this fact is commonly regarded as one of the reasons for the policy of secrecy. Others may think that the department is afraid to disclose the inconsistencies and want of principle in its decisions. However that may be, the policy is fatal to the placing of any reliance on the impartiality and good faith of the tribunal. It is a queer sort of justice that will not bear the light of publicity."

Suggested Reforms

At its special session in September last, Parliament enacted *The Excess Profits Tax Act* and *An Act to Amend the Income War Tax Act* for the purpose of raising additional revenues for the government during the stress of war. The provisions of these Acts, with respect to the taxing of corporations, "shall be applicable to the incomes of the 1940 taxation period and of fiscal periods ending therein after the 31st day of March 1940 and of subsequent periods." This legislation emphasizes, as nothing else can, the urgency for the income tax department to bring its assessments up to

date and to have settled without further delay any income tax cases that have been permitted to remain "on file" for an indefinite period.

Obvious reforms must have already suggested themselves to those having a knowledge of conditions as they exist, and we want only to mention a few remedies, some of which have already been advocated in these pages. Perhaps first and foremost from the administrative standpoint is the need to realize that the great majority of income tax questions referred to the departmental officials for consideration are concerned with accounting facts and not with law, and that in all such questions the knowledge and the background of the practising accountant are fundamental and necessary and should be utilized to the utmost by the local and central taxation officials. In respect of the various taxing statutes, the provisions giving wide powers of discretion to the minister should be eliminated. The present skeleton provisions of the *Income War Tax Act* can very well be enlarged, after the law officers of the Crown, in collaboration with a committee of prominent business men, lawyers and practising accountants, have made a study of the statutes of other countries, particularly the income tax legislation of Great Britain which has a century's growth behind it. The fact that since the *Income War Tax Act* was passed in the year 1917 only fifty appeals to date have been heard by the Exchequer Court emphasizes the need for providing at a nominal cost greater facilities for tax appeals from local inspectors to regional boards—one for the Maritime provinces, one for each of the other six provinces and one at Ottawa. Each board, the members of which would serve without remuneration, should consist of three individuals—a member of the bar with an expert knowledge of income tax law, a business man, and a member of the accountancy profession with considerable experience in public practice. As we have emphasized before, the decisions of these boards, like the decisions of other courts, should be made public. We repeat the observation made some months ago in this column that under some such plan as this there would develop a body of decisions and precedents which would serve to simplify the administration of tax legislation in Canada and would do away with the policy of secrecy which is in itself a condemnation.

There is one other aspect of this matter that we think

should be recognized by the government. In not a few departments at Ottawa, men of rare intellectual capacity and with a profound sense of responsibility have discovered all too late that the burden of office was too heavy to carry, the latest being the greatly respected Minister of Finance, Mr. Dunning. Everybody acquainted with the high qualities and ability of the present Commissioner of Income Tax realizes that for him there must come some relief from the increasing burdens of his office and that the government should effect some such re-arrangement as we suggest, otherwise we may lose the expert services of one who by his courtesy, ability and devotion to duty has won the respect of the entire Canadian public.

ACCOUNTING IN THE PUBLIC INTEREST*

by Clem W. Collins, Denver, Colorado
President of the American Institute of Accountants

It is a distinct honour, and I consider it a decidedly friendly gesture on the part of our sister Republic, to be given the privilege of addressing you and of bringing you the greetings of the American Institute of Accountants at this, the thirty-seventh annual meeting of The Dominion Association of Chartered Accountants.

While our professional intercourse has not been so extensive and intimate as I hope it shall become in the future, our commercial and social relationships have not only endured but have constantly drawn our two countries closer and closer together in bonds of friendship for more than a century and a half.

I firmly believe that the friendship which exists between this great Dominion and my own United States will come in time to have a salutary effect upon the whole world. Human beings, be they dictators or the tools of dictators, cannot in their innermost hearts resist the power of good example. Canada and the United States offer to the world a good example of how two peoples may dwell side by side without jealousy or mistrust.

It is quite possible that the dictators and sabre-rattlers have their moments when they are secretly envious, particularly when they behold this spectacle of two nations working together, divided only by a boundary which is entirely undefended on either side, excepting by customs officials. The dictators have constantly before them this example of un-selfconscious good will, and I am sure they are convinced ours is the better way. Of course, they will not admit this, but the peoples of the so-called dictator countries would say, if they were given a chance to express themselves, that ours is the better way.

Peace will come eventually to the whole world because the democracies, with moral right and sound common sense on their side, will it so. These present-day interludes of bad manners, artillery movements and shouted threats will

*Address delivered before the Thirty-Seventh Annual Meeting of The Dominion Association of Chartered Accountants, Saskatoon, Saskatchewan, 24th August 1939.

disappear. Meanwhile, ours is the duty to keep the good example of peace and quiet constantly before the world.

Independence and Integrity

Recent events have focused attention on accountants to a degree never heretofore experienced, and in a manner which has caused much concern among the members of the profession. For half a century accountants in America have been building a profession based upon the principle of independence, upon whose findings and reports full reliance may be placed.

Prior to the development of the accountancy profession, no agency existed which could be relied upon for uncoloured and unbiased facts concerning the transactions, operation and condition of business enterprises, wholly free from self-interest. Without the element of dependability the services of the accountant are of no value; hence the startling disclosure of recent months casting the shadow of doubt on current auditing procedure might well be expected to cause consternation in the ranks of the profession.

Those who have followed the discussion of the cases now being widely commented upon in the public press, are aware that that is not the case. Accountants everywhere are reiterating their confidence in the principles of accounting evolved by the profession and the technique employed in giving effect to those principles.

It is only the unusual things that make news. The very fact that two generations of accountants have reported the results of their investigation of all types of enterprises, involving all sorts of conditions and situations, and yet almost no serious errors have come to light, is in itself proof that the procedures employed by the certified public accountant are basically sound.

The remarkable thing is that instances of undetected fraud and deceit are so rare. The fact that they are so rare is a tribute to the integrity, conscientiousness and thoroughness of the professional accountant, whose reputation and livelihood depend upon the uncompromising employment of those principles.

The Public and the Accountant's Report

An interesting phase of the present situation is the implicit confidence which the public has had in accountant's

reports as indicated by the surprise that has been manifested that fraud and deceit, even of the most cunning type, should escape detection. It reveals a trust and reliance which the profession will do its utmost to deserve.

It is altogether possible that accountancy has been "oversold." That is, a general belief has apparently developed that accounting procedures are, or should be, infallible. Medical science may have its defects; the principles of engineering may fail because of unforseeable conditions; justice may miscarry because of malevolent human ingenuity and even our spiritual destination may be uncertain as a result of the diversity of human understanding and belief, but in the minds of many, accountancy seems to stand as the one science against which the machinations of the human mind should not prevail.

But, the public demands an explanation and it is altogether proper that it should. It wishes to know if the accountants involved in the cases now in the public eye were at fault. Have they failed to follow the procedure generally recognized by the profession? Are there conditions inherent in the organization of modern accounting firms which explain the failure to achieve full disclosure?

If such is not the case, then the public wishes to know if the procedures generally accepted and followed by the profession are at fault. With the utmost propriety, the investor, the creditor, and the management itself asks the question: Is there any reason why the accountant's report may not be taken as a guarantee that statements contained therein are a true picture of the operating results and financial condition of the client? If there are such reasons, what are they?

It is not my intention at this time to answer either of these questions. It is gratifying to note that for the most part commentators have displayed a willingness to await the determination of all the facts involved in the cases now under investigation. There are a few, however, both without and within the profession, who are prone to prejudge. There is no reason for unseemly haste either in defending or condemning those involved, or the methods they have employed.

Voluminous transcripts of testimony have been prepared and are now being studied and digested. Leaders in

the profession have testified concerning accepted accounting and auditing procedure. Divergence of opinion has, in some instances, been expressed, which is a healthy sign, indicating alert, independent and progressive thinking, but for the most part there is evidence of a marked uniformity of opinion as to proper procedure, indicating that there is a body of accepted principles and rules, born of experience and proved through use to be sound.

The accounting profession has long prided itself on a code of ethics equalled by few other professions. Realizing that its success rests solely on faith in its integrity and skill, it is fully prepared to take whatever steps are appropriate when all the facts are known, and the members of the profession as well as the public will be fully informed of the facts and the action taken by the American Institute of Accountants. In the meantime may we agree that to prejudge is generally to misjudge.

Accountancy is young and progressive. It can no more conform to stereotyped and dogmatic rules than can business which it serves. Accountancy may be said to be a phase of applied economics. As the economic forces which direct the destinies of business become better understood, accounting procedures may be expected to be modified and amplified. The accounting profession does not claim to be perfect. It believes that its methods which have stood the test of time and experience are fundamentally sound, but if, as a result of recent events and the review that is now being made of current practice, it is found that its methods may be improved, it may be relied on to make those improvements. Again, it is urged that the public withhold its judgment and defer its conclusions until the best thought on the subject may be obtained and substantial agreement be reached.

Accountant's Report Only an Opinion

There is much evidence that the public misunderstands the nature and purpose of accountants' reports. So far the courts have, in the main, given the proper construction to such reports, but there are continued attempts to hold accountants liable as guarantors. There is entirely too great a tendency to read the accountant's report, Chinese fashion, by beginning at the end, with this important difference: The reader too often does not read beyond the signature. If he

finds the name of an accounting firm attached, especially if it is one he knows and in which he has confidence, he is satisfied and assumes that everything is in order, and that every figure in the report may be taken at face value, although the report may be full of warning signals and qualifications.

As previously stated, it is still not understood that accounting is not an exact science which is able to produce a statement of exact values. The accountant's report is, in essence, nothing more than an opinion. It is, in practically all cases, a reliable opinion, but it is none the less an opinion. His training, skill and experience enable him, accurately to interpret the records and the transactions which they reflect with rare exception, but at some point reliance must be put on some factor which is incapable of complete verification and there must be a certain degree of reliance on human integrity.

Experience has proved that with rare exception the opinion of the chartered accountant or the certified public accountant may be relied upon in such cases, but it should be better understood that his report is, nevertheless, an opinion.

There have been a few instances in recent months where certain writers and officials whose utterance came to the attention of a considerable number of readers, have seen fit to make assertions bearing broad and uncomplimentary inferences involving the entire profession. This is but a natural result of the human tendency to jump at conclusions without being in possession of all of the facts. To avoid conviction of the profession through default in the minds of the many who read those statements, the American Institute of Accountants has felt it to be the duty, in a few instances, to reply to such statements through its publications, and to point out wherein they were in error.

No attempt to discuss cases involving individuals will be made prior to the conclusion of official hearings, but the Executive Committee of the Institute considers it to be its duty to refute unwarranted assertions or insinuations involving the profession as a whole. The accounting profession believes it is worthy of the confidence reposed in it by the public and it will stoutly defend itself against unfair attempts to destroy that confidence.

Accountants are expected to state in their certificates that their clients have kept their records and compiled their statements in accordance with accepted accounting principles. Thus far no official statement of accounting principles or procedure is in existence. This had led to considerable discussion among the members of the profession and questions on the part of the laity as to what constitutes this "Bible" so to speak, which guides accountants in the practice of their profession. It has given rise to doubts on the part of some as to whether there is such a set of principles. How can any accountant say that his client's books have been kept in accordance with "accepted accounting principles" when no one can state authoritatively what these principles are?

The casual observer may conclude from this that there are no such principles and that the task which lies before the accountants is that of laying down, through some official agency, the rules of procedure which, in the future, will guide accounting practice.

There is no question that the public is entitled to know what accountants do and how they do it, but the idea that there is no body of principles or procedures uniformly understood and followed by the profession is entirely erroneous. Accountants understand the principles well, and employ them in their practice. What is needed is not the *development* of accounting principles but their codification. Change of accounting and auditing methods is not so much the need, as some observers suggest, but rather a better understanding of just what the scope of an accounting investigation is, what assurances the accountant intends to give and what responsibilities he can reasonably be expected to assume.

It seems obvious that minimum audit procedure should be established and should be made known to all interested persons. Complete audits are seldom made. The cost of such audits would be prohibitive and the value questionable. In practically all cases, well organized tests are quite as effective and revealing as complete verifications, and the policy of testing has become established practice among accountants. It is doubtful if those who use accountants' reports fully understand this fact.

The procedure generally followed in making commercial audits has been published by the American Institute of

Accountants for the guidance of accountants and for the information of the public. A special committee of the Institute is now studying this publication to see if further improvement can be made. Similar audit procedures have been evolved for the audit of certain types of governmental units.

Possibly greater publicity should be given to these publications in order that the layman may better understand the scope of audits, but the accountant looks upon such outlines as the minimum requirements to be amplified as needed. Similarly, the failure to follow the outline completely, calls for explanation. If they are thus used and understood, it will improve the confidence of the public and the security of the accountant.

Business and Public Control

Few business men will contend that a certain degree of governmental control over business is not a beneficial development of the present era. The magnitude and widespread ownership of business enterprises today call for a certain degree of public control. The consolidation either through ownership or co-operative control of enterprises formerly competitive, have gradually increased the number of industries which partake of the nature of public utilities until business is affected with the public interest to such extent that the economic laws of supply and demand are rendered inoperative. This, together with the modern divorcing of ownership and management, makes a certain degree of governmental control necessary.

All good and necessary things are capable of abuse. Today we find a tendency to lay at the door of business the responsibility for all economic ills. Something approaching hysteria has gripped the country and in an attempt to find the cause and effect a cure, certain well-intentioned leaders of public opinion, without due regard for all the economic factors involved, are advocating and exacting measures which are so handicapping business that they are making impossible the very goals they seek to attain. Those leaders have lost sight of the fact that in an atmosphere of freedom in which a reasonable expectation of reward has provided an incentive for business enterprise, with the risks necessarily involved, your nation and ours have become the

richest nations of the world with the highest standard of living known to civilization.

We are witnessing a gradual strangling of the goose that laid the golden egg. Incentives are being removed. The expansion of legitimate enterprise is being made difficult or impossible. As a result, in my own country at least, the social advancement that the so-called reformers are attempting to bring about, is made impossible and our boasted social and economic status as a nation is in grave danger.

America is noted for the bigness of its business enterprises. Consolidation of capital and gains made possible by such enterprises, have resulted in low costs through mass production, and has made possible a standard of living in America approached by few other countries on the globe. These advantages should not be lightly swept away. Bad business practices that have been brought to light are not inherent in the plan of organization and therefore *regulation* of holding companies should be the solution, and not abolishment. Those charged with the social, economic and political welfare of our Nation, should realize that bigness is not synonymous with badness and that size has nothing to do with morality.

The business leaders of this country today recognize their social responsibility. Potential power resulting from the consolidation of great wealth in a single industry under centralized control carries with it implications far beyond that of producing an adequate return on investment. The welfare, indeed the very existence of thousands of people is involved. Industrial leaders assume their responsibility, recognizing that the interests of capital and labour are mutual in any permanent industrial system.

Taxation

Taxation is a problem common to all countries. In the United States our Federal Income Tax laws have been the subject of much discussion and frequent amendment for many years. The Committee on Federal Taxation of the American Institute of Accountants has played an important part in recommendations which have resulted in improvements in the laws, including the recent repeal by Congress of the undistributed profits tax on corporations.

It has been recommended by the Committee that the United States Government could do no one thing of greater

importance to assure the future stability of business than to create a qualified non-partisan commission to determine a permanent policy of Federal taxation.

Business is not a matter of blind hope, but one of deliberate, scientific planning, seeking to reduce to a minimum the hazards of variables and uncertainties. Taxation at high rates has become as important as material and labour costs in such planning. To the end that the uncertainty in taxes may be minimized, it is of the utmost importance that the form and incidence of taxation become fixed and measurable.

Business fears to venture when the "toll" is indeterminate nor can it venture confidently when it is threatened with taxes which violate the rudiments of corporate finance and sound accounting. The determination of fixed principles of Federal taxation should serve to bridge the existing gap between tax accounting and established commercial practice. The flexible application of accounting principles, as between taxpayers, should be stressed, with the condition that such accounting practices be consistently maintained from year to year.

In my country, and I am sure the same thing is true here, the future of accountancy, in view of changing social, political and economic conditions, is a subject frequently discussed.

Just as the accountant must be cautious in advising investors as to what they may expect in the future, so must he be cautious in predicting what the future holds in store for accountancy. It is a close relative to business, and it will, therefore, be greatly affected by the political, social and economic trends of the future.

Accountancy thrives best in the freedom of a democracy. Dictatorship or the centralization of authority over business are alike detrimental to the interests of the accountant, and to the development of true principles of accounting.

I express the hope that accountancy, in common with business, may continue to enjoy that freedom of action which has made our two Nations the outstanding commercial Nations of the world.

INVENTORY VALUATION OF PUBLIC MANUFACTURING COMPANIES

A Summary of the Round Table Discussion held at the Annual Meeting of the Association 24th August 1939 prepared by the Chairman,

James W. Taylor, F.C.A., Toronto

THE time allotted on the convention program to this discussion was two and a half hours but unfortunately the functions which preceded it on the last day of the convention fell considerably behind, with the result that the time left available for the round table discussion was only about one-half the scheduled time; for this reason it was not possible to cover all the points on the agenda. However, some interesting discussion developed on such points as there was time to consider and we were fortunate in having with us at the meeting Mr. George R. Freeman, the representative of the English Institute, and Mr. Clem W. Collins, president of the American Institute, who were able to express the English and American views, respectively, on the points brought forward.

In his opening remarks, the chairman pointed out the importance of this subject as being one with which the practising accountant is concerned in practically every set of accounts to which he is required to append his report, and in particular referred to the fact that the inventory valuation constitutes the foundation of the income statement included in the annual accounts of corporations on which the auditor is required by statute to report to the shareholders.

The discussion proceeded to deal with the various points in the same order as they appeared in the memorandum which had been prepared beforehand and which was published in the August issue of THE CANADIAN CHARTERED ACCOUNTANT.

Cost or Market

There was considerable discussion as to the implications of the expression "at cost or market, whichever is lower" which appears in the description of the inventory valuation in the published accounts of a large number of public companies. The view was put forward that a manufacturing

company might be considered as having two markets—that in which it buys its raw materials and that in which it sells its finished products—and that prices in both of these markets current at the inventory date should be taken into consideration in establishing "market" valuation for comparison with laid-down cost in the case of raw materials, and with manufactured cost in the case of goods in process and finished products. It was brought out that the general conception of "market" in this country is the cost of replacing the inventory at market prices prevailing at the inventory date and that it is the general practice in Canada to write down inventories on hand to the basis of market in cases where such valuation is lower than cost, this adjustment being applied not only to raw materials on hand but also as to the raw material content of goods in process and finished stocks. It was discussed that this basis of inventory valuation, in the case of companies using raw materials which are subject to violent fluctuation, had occasionally brought about a switching of profits between years which had proved to be artificial owing to selling prices not following closely the course of raw material prices. It was agreed, however, that this basis of inventory valuation had established itself so firmly over such a long number of years as to merit its acceptance as the general practice, it being recognized that the basis is not applicable in some special lines of business. One of our Western friends gave as an instance the grain business where the inventory is protected by hedging; in that case it was agreed that the proper basis of valuation is market at the inventory date, regardless of cost. Another Western member brought up the case of a land company where the current selling value had fluctuated between $15.00 and $100.00 per acre in a comparatively short space of time; the question arose as to what is "market" in this case? It was discussed that the position here was different from that of a manufacturing company which was turning over its raw material two or three or more times a year, and that the case in point was one to which the industrial "cost or market" basis would not apply. The occasion seemed to be one in which the auditor would be well advised to make some reference in his report to the values at which the unsold lands are carried, if such values are in excess of current realizations.

In the case of goods in process and finished stocks included in inventories it was discussed that in addition to a comparison of the valuation of the raw material content thereof with the prices prevailing in the "buying" market, a comparison should be made with the realizable value of these products in the "selling" market and that an adjustment would be called for in cases where the spread between inventory valuation and current realization was insufficient to meet the selling and other expenses which still had to be met before the sale of the goods could be completed, plus a margin of profit.

Mr. Collins indicated that the practices set out above are in line with those followed in the United States. It would seem that in England the practice of writing down to replacement value, when less than cost, is not so general as it is on this continent. Mr. Freeman instanced an income tax case with which he had been connected where the British taxing authorities required that the inventories be included at cost (regardless of replacement value) for the purpose of the tax calculations, on the grounds that after such inclusion the company was still able to sell at a profit. Mr. Freeman had already made some reference to the question of market value in his address delivered to the convention prior to the round table discussion; the formula which he suggested for establishing market value is:

> "present realizable value of the goods in the condition in which they exist, or ultimate realizable value discounted to the present time by taking into account further expenses on the goods and interest on the outlay until sold."

There was some discussion as to whether adjustments of inventories downwards to market should be shown separately in the published accounts of the company concerned and as to whether such adjustments might be considered as coming within the description of "profits and losses of a special nature" which the Dominion companies act requires shall be set out separately in annual accounts. The question was discussed also as to whether some reference to the write-down should be made in the income account of the following year as that account is also affected through the write-down of its opening inventory. In this connection reference was made, as an example, to the annual

accounts of one of the rubber companies in the United States in which a write-down to market of some $10,000,000 was shown separately in the published accounts of the year in which the write-down took place, and in the accounts of the following year the amount of the write-down is mentioned in a footnote under the figure of "cost of goods sold."

The outstanding point which was stressed throughout the "cost or market" discussion was the all-important one, particularly from the point of view of the correctness of the annual income account, of pursuing a *consistent* basis of inventory valuation from year to year.

Overhead Expenses Included in Inventory Valuation

The point discussed in this connection was the possible inflation of inventory valuation through the inclusion of excessive overhead expenses,—for instance, overhead applicable to a "shut-down" period caused by lack of orders or curtailment of production arising from any other source. Here again it was considered that it was most important to follow a *consistent* policy, and that any serious overstatement of inventory valuation caused by the inclusion of excessive overhead would come to light in the comparison of manufactured cost with current realization in the "selling" market.

Mr. Collins brought up at this point a case which had come within his experience as serving to illustrate the difficulty of drawing a distinct dividing line between those overhead costs which might properly be included in inventory valuation and those which should be excluded. Mr. Freeman referred to the English understanding of the basis of inventory valuation as being "the works cost of production." The discussion brought out that there were bound to be overhead expenses which were on the "borderline," and that the inclusion (or exclusion) had to be decided through a detailed consideration of the purpose for which the expenditures were incurred, it being the general experience that even after such consideration, a more or less arbitrary disposition of some classes of expenses might be necessary in order to complete the distribution.

Plant Depreciation and Inventory Valuation

It was brought out that in some cases within experience costs (and therefore inventory valuation) had been based

on a provision for depreciation which was greater than that set up in the financial accounts—through the inclusion in the costs of a provision on plant which had already been fully depreciated on the books. The result of the discussion was to the effect that whereas a calculation on this basis might be appropriate for the purpose of setting a selling price, it would be improper to include in the inventory valuation a provision for depreciation on a higher level than had been actually charged to the current income account.

Valuation on Principle of "Basic" Inventories

The theory of the basic stock method of inventory valuation is that there is a certain normal investment in inventories which requires to be maintained at all times although physically the stocks are used up and replaced by other like stocks. To the extent of this "normal" stock the investment in inventories is considered to have assumed the nature of fixed capital, which (as in the case of other capital assets) should not be affected by the outside influence of price fluctuations but should carry the same valuation from year to year. The principle recognizes the propriety of applying the "cost or market" yardstick in pricing inventories carried in excess of the normal requirements.

The basic stock method has not been adopted in any general way in Canada, even by the industries to which it is considered chiefly to apply, such as:

(a) Industries producing basic raw materials.

(b) Industries in which the greater part of the cost of the finished product is the cost of the basic raw material entering into its manufacture.

(c) Industries where the processing period is long, necessitating the keeping in process of a constant minimum amount of raw material of considerable importance.

It was stated by one of the members that he understood the income tax department enforces this basis of inventory valuation in the black fox industry. Mr. Collins reported that in the United States this theory of inventory valuation, although considered to be an interesting one in regard to certain industries, had been found so difficult of practical application that it had not been adopted to any extent. Mr. Freeman informed the meeting that the basis had been

recognized in England in a modified way in connection with the accounting for munitions contracts during the Great War.

Other Points

Owing to lack of time the other points included on the agenda were merely touched upon and their consideration did not reach the stage of a discussion.

The practical advantages accruing from the use of "standard" costs were fully recognized but there seemed to be a tendency to endeavour to force standard costs, on account of their convenience, into industries to which this method of costing is quite unsuited.

It was unfortunate that time was not available for a full discussion of item (9) on the agenda*, namely, as to whether the wording generally adopted in describing inventories on balance sheets submitted with annual accounts was a strictly correct interpretation of the requirements of the Dominion companies act. There would seem, for instance, to be some conflict between the wording referred to and the fact that the balance sheet is the company's balance sheet and not the auditor's.

Discussion was not reached on the question of whether the *amounts* of inventory reserves, where such exist, should be disclosed on the balance sheet. Such a discussion would have been of interest in view of the fact that out of the eleven inventory descriptions taken from published annual accounts and reproduced in the memorandum written in preparation for this discussion, no less than four conclude with the words "less reserves" without any reference to the amounts thereof.

American Institute Report re Extension of Auditing Procedure

Although having reference to *verification* rather than *valuation* of inventories, it was thought that it would be timely to discuss at this meeting the report brought in by a special committee of the Amercan Institute of Accountants under date of 9th May 1939 wherein it is recommended that auditing procedures be extended to cover a physical test-check of inventories in all cases where "practicable

*See page 119 of the August issue of *The Canadian Chartered Accountant.*

and reasonable." The two points of view which have been freely expressed on this subject since the report referred to was published were aptly put before the meeting by two of our members.

The danger of holding out to clients and to the public that auditors are concerning themselves with the physical aspect of inventories was stressed by one of the Western members who admitted that if he undertook to make a physical test of the inventories of one of his grain clients he could not tell the difference between "No. 1 hard and No. 6 tough smutty burnt." In his opinion any serious discrepancies in inventories should come to light through a careful examination into the purely accounting records relating to the inventory, and that there was grave danger to the auditor in his undertaking any responsibility for inventories in a physical way, as in the very nature of things an auditor could not be expected to be conversant with the size, style, grade, nature, composition, etc., of the various assortments of materials and goods handled by all his clients.

The second point of view expressed on this subject was to the effect that an auditor's clients and the general public would be able more readily to understand the limitations of an auditor's responsibility in connection with the test-checking of physical inventories than his failure even to go and see that the inventories really exist.

It was pointed out by Mr. Collins that the report of the special committee of the American Institute emphasized the fact that the procedure recommended did not mean that auditors were setting themselves up as valuers or appraisers of inventories, but that they were merely going to make physical tests as to the existence of the inventory wherever practicable, and where such tests are not made for any reason the auditor's report must so state.

This question of physical test-checks of inventories was recognized to be a most important one which required a closer study than could be given at a gathering such as this. It was therefore put to the meeting and unanimously agreed that a recommendation be sent forward to the council of the Dominion Association that the report of the American Institute here discussed be referred to a special committee of the Association for consideration and report. This recom-

mendation was acted upon immediately by council and the matter was referred to the Accounting Research Committee of the Dominion Association.

THE AUDITORS' REPORT TO THE SHAREHOLDERS

An Appeal to the Council of The Dominion Association of Chartered Accountants for Leadership

In the July 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT there was published a "Memorandum Regarding Roundtable Discussion at Annual Meeting in Halifax, August 1938." In this memorandum it states that "the Committee has decided that the roundtable gathering be devoted to a discussion of: 'Should the Statutory Form of the Auditors' Report to the Shareholders be changed?'" The memorandum contains also seven definite points for consideration with special reference to the "American form of certificate."

In the August 1938 issue there were published twelve "Auditors' Reports" which had been taken at random from recently published financial statements and in the December 1938 issue there appeared a summary of the roundtable discussion prepared by the very able chairman who presided over the meeting, K. W. Dalglish, C.A., of Montreal.

The chairman stated in the second paragraph of his summary that "the meeting was very fully attended and it was obvious that the subject was one in which every one present was earnestly interested." Whilst at the conclusion of the discussion Harvey Crowell, C.A., of Halifax, is reported to have said "There may be a number who are burning to say something on this question. Is there any reason why they should not write it and send it to THE CANADIAN CHARTERED ACCOUNTANT? The discussion could be carried on without waiting for the next annual meeting."

The Companies Act (Dominion) contains the following provisions with respect to the auditors' report to the shareholders, (Section 120):

(1) The auditors shall make a report to the shareholders on the accounts examined by them and on every balance sheet laid before the company at any annual meeting during their tenure of office, and the report shall state

(a) whether or not they have obtained all the information and explanations they have required, and

(b) whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company.

As a result of these provisions there has been evolved an "Auditors' Report" the use of which has become Dominion-wide, subject of course to varying qualifications to meet special cases. This well-known form of report is as follows:

We have examined the books and accounts of the.......................... Company Limited for the year ended .... and have obtaned all the information and explanations we have required. In our opinion the above balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of our information and the explanations given to us and as shown by the books of the company.

In 1934 the American Institute of Accountants issued to its members a pamphlet dealing with a standard form of auditors' report. The form of report now generally used in the United States of which the following is an example is based on that recommended by the Institute.

We have made an examination of the balance sheet of the X Y Z Company as at 31st December 1937 and of the statement of income and surplus for the year 1937. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company: we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination, the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting cosistently maintained by the Company during the year under review, its position at 31st December 1937 and the results of its operation for the year.

A year or two after the issue by the American Institute of the pamphlet dealing with a standard form of auditors' report it became evident that some of the members of the Canadian Institutes were interested in the American form

of report and were incorporating it in whole or in part in their own reports on the accounts of Canadian companies but at the same time they were retaining the wording required by Section 120 of the Companies Act (Dominion). The result of this was a "composite" form of report, a sample of which is given below:

We have made an examination of the balance sheet of .... as at December 31st, 1937, and of the profit and loss and earned surplus accounts for the year ending on said date. In connection therewith we examined or tested the accounting records and other supporting evidence and made a general review of the accounting methods and of the operating and income accounts for the year but did not make a detailed audit of the transactions.

We have obtained all the information and explanations we have required, and, based upon such examination, report that, in our opinion, the above balance sheet as at December 31st, 1937, is properly drawn up so as to exhibit, (in accordance with accepted principles of accounting consistently maintained by the company during the year under review,) a true and correct view of the state of the affairs of ...., according to the best of our information and the explanations given us, and as shown by the books, and that the related profit and loss and earned surplus accounts fairly present the operating results for the year.

In his opening remarks at the roundtable discussion the Chairman had this to say:

Two years ago the Legislation Committee of our Association made recommendations to the Department of the Secretary of State in Ottawa regarding suitable amendments to the Dominion Companies Act. At that time we did not make any suggestions regarding the section dealing with the report which the auditor is required to make to the shareholders. There was, in the minds of some of us at that time, the question as to whether or not certain features of the American form of certificate might be adopted by us, but I think we felt that we would like to see a few more years of experience in the United States with that form of certificate before considering the matter further.

In England one form of certificate is used and is very rarely deviated from, and I think that is perhaps the greatest benefit of any form of certificate: the extent of its general adoption. In the United States it would seem that arising out of the decision in the *Ultramares* case, American accountants got together and a special committee headed by Mr. George O. May working in co-opera-

tion with the New York Stock Exchange, devised a form of certificate which was considered satisfactory. That form is now being used very largely all through the United States; so that in the United States also one form is being generally adopted. In Canada unfortunately we seem to be breaking away. Mr. Carr was kind enough to go through a large number of annual reports of companies and the certificates published in this pamphlet are only a few extracted from these reports, but which indicate that we are rapidly departing from uniformity. We of course are in the position of being influenced to a great extent by American practice. Auditors of subsidiary companies in Canada of American companies are sometimes asked to use the American form of report, and they have wound in with that form certain additional phraseology so that it will comply with the Dominion Companies Act. There also has been a tendency to use it or some similar form for purely Canadian companies. For these various reasons, in arranging for this annual meeting it seemed that it would be an appropriate time to have a discussion on this subject.

Mr. George Cochrane of New York, who was present at the meeting in Halifax and who had been a member of the Committee of the American Institute which drafted the "American" form of certificate made the following interesting remarks about the phrase "but we did not make a detailed audit of the transactions:"

> In regard to the language 'that we did not make a detailed audit' this is the only disclaimer that there is in the certificate. The committee had the advice of more than one lawyer and they all advised that disclaimers should not be made unless it was quite certain that everything which should be disclaimed was disclaimed. For instance, accountants do not examine the documents recording the existence of real estate. They do not as a rule actually take inventories, these being matters which in the United States and, I believe, in the rest of the world generally we are not supposed to undertake. But in the United States it might be said that if a disclaimer was made on one thing then, because a disclaimer was not made on others, a reader of the certificate would be entitled to assume that if they had not been done a disclaimer would have been made. The evidence in the *Ultramares* case was that certain minor subsidiary records had not been examined but because the accountants had stated that they had 'examined the books' the court said that meant everything. It was the committee's opinion that it is not the practice anywhere in the world to examine everything, except in very

small cases, and therefore in view of the decision in the above mentioned case a disclaimer was necessary in this respect.

Another visitor from the United States also spoke as follows:

If I may express an opinion, I think the suggestion made by your Chairman is a wise one, that you should not consider going very far along the lines of the certificate now very widely used in the United States until a few more years of experience have been had with it.

The committee which formulated the standard certificate was working in January and, as accountants had to get out their certificates on accounts as at the prior December 31, it was expedient that a certificate should be formulated which could be generally used. I do not think that it is something which should be copied by you and, particularly so as it is at present under consideration and, I believe, will be altered and changed at an early date. It is not considered entirely satisfactory even from our point of view and I believe that the majority are quite willing to change it when it has been decided what changes are necessary.

By permission of the American Institute of Accountants there was published in the June 1939 issue of THE CANADIAN CHARTERED ACCOUNTANT the report of the special committee appointed by the Institute to consider "extensions of auditing procedure." This report apparently was not authorized to be printed and distributed to members of the American Institute until 9th May 1939 and as our own magazine is reported as going to press about the middle of the month the publishing of the report in the June issue of THE CANADIAN CHARTERED ACCOUNTANT showed excellent teamwork on the part of the secretary of the American Institute and the secretary of the Dominion Association for which they deserve to be congratulated.

The revised form of auditors' report which has been adopted by the Institute on the recommendation of the special committee is as follows:

Short Form of Independent Certified Public Accountant's Report

To the Board of Directors (or Shareholders) of the X Y Z Company:

We have examined the balance sheet of the X Y Z Company as of April 30, 1939, and the statements of income and surplus

for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company, and have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate.

In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the X Y Z Company at April 30, 1939, and the results of its operations for the fiscal year, and conform to generally accepted accounting principles applied on a basis consistent with the preceding year.

A comparison of the new form of report with the old shows the following major changes:

1. The phrase "obtained information and explanations from officers and employees of the company" has been omitted,
2. The statement "but we did not make a detailed audit of the transactions" has been omitted, and
3. The words "based upon such examination" have been excluded.

Of still greater interest however is the decision to recognize as "normal audit procedure" where inventories are a material factor, the making by the auditor of physical tests by count, weight or measurement or the observing by him of the making of such physical tests. Should the auditor not do this he must make suitable explanation or exception in his report.

It has also been decided to recognize the confirmation of notes and accounts receivable by direct communication with the debtors as "normal audit procedure" in cases where the aggregate amount of such notes and accounts receivable represents a significant proportion of the current assets or of the total assets and if this is not done the auditor must make suitable explanation or exception in his report.

The question which now arises in the minds of many members of the profession in Canada is: If the form of Auditors' Report adopted by the American Institute in 1934 had so marked an effect on the wording of the auditors' report to the shareholders of Canadian companies, what will be the effect of the new form which was adopted in May of this year? Unless the members of the Council of the Dominion Association take this question into their own

immediate consideration or appoint a strong committee—not necessarily composed of Council members—to give the profession some guidance the result in the next year or two will be that we shall have in Canada one section of the profession using the present customary form of Canadian report, another section using the present "composite" form whilst a third will probably be using in whole or in part the revised form just adopted by the American Institute with appropriate qualifications or otherwise as to inventories and accounts and notes receivable. It is with the earnest hope that this condition may be avoided that these notes have been compiled.

A. MEMBER.

Editor's Note—The editorial committee is pleased to publish these observations of "Member." It should be kept in mind that the notes were prepared and submitted to the Magazine Committee some weeks before the American Institute of Accountants held its annual meeting in San Francisco in September. It is now reported that at this meeting the new form of auditor's report together with the recognition as "normal audit procedure" of physical tests of inventories and test confirmation of receivables were the subject of much discussion, as a result of which some changes in both the form of the report and in the "'normal audit procedure" may be made. It should also be noted that at the annual meeting of the Dominion Association held in Saskatoon at the end of August the Council appointed a special Committee of the Association to make a study of the report of the American Institute on "extensions of auditing procedure" and in particular the reference therein to inventory valuation and verification, and to bring in a report to the Council.

CANADIAN AGRICULTURE AND THE WAR

AS NOTICED in last month's issue the Budget Speech of September 12th pointed out that the real cost of the war would, with qualifications which are comparatively unimportant, fall on the generation which fought the war. This is clear if the war is financed by taxation and, on reflection, it is equally clear if the war is financed by loans floated internally and such loans are in fact the only ones available to us. Neither by taxation nor by such loans can the production of some later period be made available for the needs of the present and hence the burden of the war is a burden of the war generation of Canadians.

It is obvious of course that posterity will bear part of the burden of the war in the sense that the war generation will pass on to it a population and a capital equipment depleted by the ravages of war. And indeed it will be not only a depleted population and equipment but it will also be a population and equipment trained and adapted for war and not for peace purposes. This is a matter for serious consideration.

In this connection the Honorable J. G. Taggart, the competent Minister of Agriculture for Saskatchewan, in the course of an address on War and Western Agriculture made some significant observations. He considered any net expansion of agricultural production in the west inadvisable and he thought Western Canada should not plan for any drastic change in its agricultural set-up. He supported this position by an analysis of production in recent years in western Europe, pointing out that there was no indication of an immediate demand for more wheat from Britain and France. There certainly will not be any such expansion of our wheat acreage as there was in the last war, the difficulties associated with which still are part of our agricultural problem. To expand and distort our economy for an uncertain and ephemeral war demand for wheat might be very unwise, both in the interests of ourselves and of the cause we have taken up. What the war will require of us is very quick "foot-work" in shifting our productive power in agriculture from one group of products to another and that our "foot-work" may be effective means that our minds must be alert. Acreage which is shiftable from one use to another must be prepared to shift quickly. Each

part of the country must bear some of the burdens of the other parts and there is no room now for the peanut politics of provincial sectionalism. For example, if our markets for apples abroad have failed, it is both helpful and wise that Canadians should eat more apples.

Mr. Taggart showed how an alert supervision over the quickly changing problems of agriculture in the war can bring it about that the agricultural industry we hand to posterity will be one that has served well our cause in the war and also is one that is in no danger of becoming a major post war problem. How badly our productive assets of men and equipment will be depleted depends on the duration and severity of the war but thoughtful action now can minimize somewhat the degree of distortion of our economy which will be caused by the war. Flexibility in the Canadian economy is a strength both in war and in peace and quick "foot-work," which is to be more than mere movement, requires intelligence. A Canada for example that buys in, during the war, Canadian debt held abroad will have to be very nimble to adjust herself to the far-reaching consequences of such a change for it will affect our international position very greatly. This point is of sufficient importance to merit separate discussion at a later date.

R. McQueen.

Winnipeg,
18th October 1939.

***Editor's Note*—Professor McQueen is Professor of Political Economy at the University of Manitoba.**

A NOTE ON WAR TIME WHEAT PRICES

ALMOST everyone associates high prices with war. Prices of many basic commodities have already risen. Speculators are anticipating rich rewards and consumers have increased their purchases of sugar and flour in the fear of higher prices.

There are, of course, historical foundations for these expectations. Wheat did go over two dollars a bushel during the last great war, but it is well to remind ourselves that it took several years for this to occur. In August of 1914 there was a sharp rise in the general level of commodity prices but a decline took place in October and prices remained at this level for almost a year. Then prices moved upwards and reached a peak some time after the cessation of hostilities.

There is no reason to expect that prices during this war will follow in any way the course taken in the last war. There are many factors which point to such a conclusion.

First it is well to remember that during the last war price controls came in only after a period of unregulated speculation. Price controls are now in operation. Similarly, centralized purchasing by the belligerent countries, and controlled single agency selling by exporting nations have already established a series of administered prices for many basic commodities.

Further, the present conflict was not unexpected. Huge stocks of basic commodities were accumulated by war-jittery nations and purchased at depression prices from depression surpluses. This was particularly true of wheat.

As to the wheat situation itself there are a number of factors which are more bearish than bullish. All of the warring European nations have been prosecuting "a battle of wheat" for some years in anticipation of what has now happened and with a vivid memory of what occurred in 1917 and 1918. Wheat growers have received subsidy prices, and acreage in Western Europe, with no significant increase in population, is greater now than in 1914.

The wheat exporting nations expanded their acreage during the last war and have not decreased it since. Indeed

since that time so rapid has been the progress of farm mechanization that the wheat industry of the new world has been geared to war-time production for many years. Nor can we expect, since our plant breeders have gone to work, that the rust epidemic which proved disastrous in Western Canada in 1916, will be repeated.

There has been no change in the basis statistical wheat position in the last month. There is still twice as much wheat available for the normal demands of international trade. There are no more people living to eat this wheat and no reasonable expectancy of a change of diet which would increase bread consumption. The convoy system which came into effect late in the last war is now operating to secure greater safety of food supplies for the allies. There will be less wheat at the bottom of the ocean.

What we should remember is that a price rise in wheat can be sustained only as the result of a reduction in supply or by an increase in the desire and ability to buy. It seems then that the "wheat supply situation" will for some time far outweigh any strengthening of the "demand factors."

Many Canadians are quite concerned at present over the apparent unwillingness of Britain to buy Canadian wheat. No outsider can advance with assurance reasons for this apathy. Certain good reasons suggest themselves. It would be the part of wisdom for the British Government to "mop up" the wheat supplies of the Danube basin. Wise because it would deprive Germany of potential sources of supplies, and it is also wise to make purchases in those countries whose friendship you desire to maintain and whose economic structure needs support against the economic penetration of our enemies.

So also is there good reason to continue purchasing Argentine wheat and thus keep our export markets in South America for Welsh coal and other products. Germany has been making great inroads into South American markets. This is the time to regain these markets.

We should then not be too hasty in condemning the present British wheat purchasing policy. As has often been said this war is going to be won on the economic front. The Canadian wheat industry expanded and prospered in the last great war. Later on this expansion brought on great difficulties which fundamentally still exist. A long

war may see a sharp rise in wheat prices. At present the price of wheat in Canada is out of line with the prices of goods the farmer must buy in order to live and produce. This maladjustment will be hard to right in the face of bulging elevators and increased demand for industrial goods. The speculative rise in wheat prices, of a few weeks back, shows signs of wearing out. It was largely psychological. My personal opinion is that the price of wheat for this crop year at least will be governed by what statesmen think is politically expedient. That is to say, there is nothing in the statistical position to indicate that it will be higher; and higher prices can only be sustained by some form of Government action designed to protect wheat growers and the industry in general.

Many people in Western Canada expected the war to solve our wheat problem. This problem can be succinctly stated as one of dwindling foreign demand, increasing surpluses and falling prices. As long as markets are restricted and supplies more than ample, prices will be low. The ordinary consequences of economic forces persist despite political unrest. Why then should wheat prices go higher? It is easy to believe that they should be higher because a 70c price is too low to maintain our Western economy at a reasonably prosperous level. But this is after all only a matter of opinion no matter how strong a case its supporters may put forth. Any higher fixed price would be based on a disregard of the forces which are making the open-market price.

H. C. Grant.

Winnipeg,
16th October 1939.

Editor's Note: **Dr. Grant is Associate Professor of Political Economy at the University of Manitoba and one time Commissioner of the Canadian Wheat Board. He has already contributed to THE CANADIAN CHARTERED ACCOUNTANT, his article "The Background of the Wheat Problem" having been published in the September 1935 issue.**

INCOME WAR TAX ACT DECISIONS

1. The Julius Kayser & Company Limited Case

(Exchequer Court of Canada)

This decision is of note as furnishing an illustration of the exercise by the Minister of National Revenue of power conferred upon him by section 23A of the Act. The judgment was rendered on 29th September 1939 by Mr. Justice Angers of the Exchequer Court of Canada. The section provides that whenever a Canadian company has advanced moneys to a non-resident company and such advances remain outstanding for a period of one year without any interest or a reasonable rate of interest having been paid or credited to the Canadian company, the Minister may determine the amount of interest on such moneys which shall be deemed to have been received as income by the Canadian company.

The Facts

The appellant made advances aggregating $424,889.44 to Julius Kayser & Company of New York which owned beneficially all the issued shares of the capital stock of the appellant (except directors' qualifying shares). Such advances had been made prior to 1st July 1934, and the amount remained outstanding during the whole of the appellant's fiscal period ending on 30th June 1935 and no interest was paid thereon. The Minister decreed, pursuant to section 23A that interest at 3% on the said amount, or $12,746.68, should be deemed to be received as income by the Canadian company and assessed the appellant for additional income tax on that sum.

Contention of Appellant

The appellant referred to sections 18 and 20 of the Act. Section 18 provides that any loan or advance by a corporation to a shareholder, other than a loan or advance incidental to the business of the corporation, shall be deemed to be a dividend to the extent that the corporation has on hand undistributed income and such dividend shall be deemed to be income received by such shareholder in the year in which the loan is made. Section 20 is authority for reducing the undistributed income of the corporation by the amount so deemed to be received by the shareholder as a dividend by virtue of section 18. Officers of the appellant

testified that the advances to the parent company took the form of withdrawal by it of excessive cash belonging to the subsidiary. While the cost of purchases of raw silk for the subsidiary by the parent company in New York were credited to the parent company in reduction of its debt to the subsidiary it was contended that the loans to the parent company could not be said to be incidental to the subsidiary's business. The size of such purchases was small in relation to the amount on loan. Not being a loan incidental to the subsidiary's business, it was argued that section 18 must apply and the loan be deemed to be a dividend. Such a dividend when paid to a non-resident parent company by a subsidiary was made exempt from the 5% tax under section 9B by subsection 11 thereof. By virtue of section 20 the undistributed income of the Canadian company was reduced by the amount of the dividend deemed to have been received.

Judgment

Mr. Justice Angers dismissed the appeal. He did not think that the question at issue came within the scope of section 18. If he had concluded otherwise he would nevertheless have believed that the advances were incidental to the business of the appellant. He stated that the object of section 18 was to create a tax against a shareholder who received a dividend under the disguise of a loan or advance. The section had nothing to do with the corporation which paid out the loan or advance. If the appellant had wished to declare as dividends the advances made to the parent company, such dividends would have been exempt under section 9B(11). There was nothing to show that the advances were intended as dividends. In fact all evidence was to the contrary.

2. Decision in the Bessie L. Shaw Case Reversed

(Supreme Court of Canada)

On the further appeal by Bessie L. Shaw against an assessment confirmed by the Minister of National Revenue, the Supreme Court of Canada on 3rd October 1939 reversed the decision of Mr. Justice Maclean of the Exchequer Court of Canada. The judgment of Mr. Justice Maclean confirming the assessment was referred to in the January 1939 issue of THE CANADIAN CHARTERED ACCOUNTANT. Briefly, the

appeals concerned an assessment of the sum of $8400 received by Mrs. Shaw in 1934 as income. The sum was received by Mrs. Shaw from the Sun Life Assurance Company pursuant to a policy placed by her on her husband's life. The husband died in 1933 and Mrs. Shaw had the option of receiving 120 guaranteed monthly payments of $700 each with additional monthly payments of the same amount until she died if she was still alive at the end of the guaranteed term or, alternatively, of receiving, on her husband's death, a single cash payment of $71,400. Mrs. Shaw elected to accept the first option and, accordingly, was paid $8,400 in 1934.

Contention of the Crown

The Minister contended, and his argument was successful before Mr. Justice Maclean, that, with reference to section 3(b) of the Act, the single payment option would have represented "proceeds of a life insurance" if accepted by Mrs. Shaw and the entire payment would have been exempt. It was argued that when Mrs. Shaw elected to take the alternative option the effect was the same as if she had taken the single payment and reinvested the moneys with the Insurance Company in an annuity contract. Under section 5(k) an exemption is granted in respect of the income from certain annuity contracts but, it was urged, the contract of the type here said to have been constituted was not entitled to the exemption which extended only to Dominion Government and other "like" annuities. Finally, it was contended, the payments represented "income from a life insurance policy paid upon the death of the person insured" and were, therefore, taxable as income pursuant to section 3(b).

Judgment

The Supreme Court of Canada was unanimous in allowing the appeal with costs throughout. Three of the five judges wrote reasons and those of the Chief Justice, Sir Lyman Duff, were concurred in by Messrs. Justices Crocket and Hudson. The Chief Justice repeated the cardinal principle in the construction of taxing Acts, saying,—"It is no part of our duty in construing and applying a taxing statute to ask ourselves what might have been in the draughtsman's mind or to accept the impression received from a casual inspection of the enactment to be applied. It is our

duty to analyze such enactments with strictness and, in the case of a definition such as this (section 3), to apply it only to those cases which plainly and indubitably fall within it when strictly read." In a careful and lengthy analysis of section 3 defining income, the Chief Justice pointed out that, after specifying that income was to include income from certain sources, the section declared that the sources themselves were not to be considered income. Amongst these sources were included "the proceeds of life insurance policies" whereas the income from such proceeds was made taxable. Mr. Justice Maclean had stated that section 3(b) contemplated the taxation of income derived from life insurance contracts and annuity contracts. Sir Lyman Duff commented upon this that, with great respect, he thought it was "stated rather too absolutely." He thought there was no doubt that the legislature had made it plain that it was income derived from the *proceeds* of life insurance and annuity contracts that was to be taxed. The legislature was at pains to emphasize the distinction between income and the source of income. The income derived from the capital source was income for the purposes of the Act and the source was not income for the purposes of the Act. Undoubtedly part of the annual payments could be said to be of an income nature but there had been no attempt to segregate capital from income and the Crown had not put its case on the ground that some part, at least, of the payments were of an income nature. Therefore the whole assessment was set aside. Mr. Justice Kerwin stated his opinion that the monthly instalments were just as much proceeds of life insurance policies as any single cash payment.

NEW LEGISLATION RESPECTING TAXATION DOMINION AND PROVINCIAL

Editor's Note: The information published under this heading indicates only in general terms the nature of recent legislation of the Provincial Governments respecting Taxation. Amendments of the *Income War Tax Act* (Dominion) are published in full.

In the October 1939 issue of THE CANADIAN CHARTERED ACCOUNTANT, the text of *An Act to Amend the Income War Tax Act* and of *The Excess Profits Tax Act* was published. These acts were passed at the special session of Parliament called on 7th September 1939. In the August and September issues summaries of the 1939 amendments of provincial tax acts passed by the provincial legislatures up to that time were published.

At a special session in September 1939 the Ontario legislature passed two acts respecting taxation, *The Corporations Tax Amendment Act 1939* and *The Income Tax Amendment Act 1939*. The principal features of these amendments are as follows:

(Continued from October issue)

Ontario

The Corporations Taxation Act—Subsection 4 of section 14, respecting exemptions and deductions, is amended by adding thereto the following clause:

> "(h) The amount, not exceeding ten per centum of the net taxable income of any incorporated company, which has been actually paid by way of contribution within its fiscal year to, and receipted for as such by, any patriotic organization or institution in Canada which hereafter receives the written approval of the Secretary of State of the Dominion of Canada."

This provision came into force on 22nd September 1939 and applies to companies in respect of all fiscal years ending during 1939 and subsequent fiscal years.

The Income Tax Act—Subsection 1 of section 5, respecting exemptions and deductions, is amended by adding thereto the following clause:

> "(n) the amount, not exceeding ten per centum of the net taxable income of any taxpayer, which has been actually paid by way of contribution, within the year to, and receipted for as such by, any patriotic organization or institution in Canada which hereafter receives the written approval of the Secretary of State of the Dominion of Canada."

This provision came into force on 22nd September 1939 and apapplies to the incomes of the year 1939 and all fiscal periods ending therein and to the incomes of all subsequent years and fiscal periods.

REPORT OF MAGAZINE AND PUBLICATIONS COMMITTEE*

The President and Council,
The Dominion Association of Chartered Accountants.

Gentlemen:

Your Committee on Magazine and Publications has pleasure in presenting the following report for the year ended 31st May 1939.

THE CANADIAN CHARTERED ACCOUNTANT continues to grow not only in the number of subscribers and in its usefulness as an important reference on accounting and related subjects, but also in public esteem, if the references to it in the press throughout Canada may be regarded as any criterion. In fact a number of newspapers throughout Canada have republished in their own editorial columns extracts from some of the editorials appearing in our magazine. Your committee feels that the whole profession is greatly indebted to our editor, Mr. A. H. Carr, for the service which he is rendering to the profession in general through his monthly editorials.

The total circulation at 31st May was 3808 as compared with 3646 last year, which may be regarded as a normal increase. As in previous years, an announcement of the articles appearing in current numbers has been published monthly in "The Financial Post" (Toronto) and "The Financial Times" (Montreal).

The students of several of the Provincial Institutes are among the regular subscribers, their subscriptions being arranged through the Institutes. Since the Magazine should not be overlooked as one of the references in accounting studies, your Committee anticipates the day when every registered student of the Institutes will be a subscriber.

An examination of the contents of the twelve issues for the year shows that, apart from the editorial comments, notes, memoranda and accounting problems and solutions, forty-eight articles were published on the following subjects:

*This report of Mr. Saunders' Committee was presented at the annual meeting of the Association in Saskatoon in August and, at his request, is published in *The Canadian Chartered Accountant*.

Accounting and auditing	19
Professional matters	7
Taxation, including income tax	6
Financial and industrial	7
Miscellaneous	9

Twenty-six of these articles were written by members of the Provincial Institutes, as follows:

Alberta	7
British Columbia	3
Manitoba	3
Nova Scotia	1
Ontario	7
Quebec	5

Your Committee has experienced some degree of satisfaction in the service provided to its readers on the subject of taxation. The annual income war tax act amendments are being published in full and a summary made of the annual amendments of provincial tax acts. The judgments of the Exchequer Court of Canada in income tax cases have been appearing in THE CANADIAN CHARTERED ACCOUNTANT before their publication in any of the law reports.

The Terminology Department under the able direction of Mr. John Parton continues to be an important feature of each issue, and the Executive Committee has arranged for offprints of the dictionary of terms appearing therein for distribution to the members of the Association. An additional feature this year has been the column on Stock Brokers' Accounts kindly prepared by a committee with practical knowledge of the subject. The Students' Department, with the capable assistance of Professor Smails, has been an important section of the Magazine now for the past nine years. To those who have contributed their time and efforts to the success of these departments your Committee expresses appreciation.

Your Committee also wants to record its gratitude to all who contributed to the pages of THE CANADIAN CHARTERED ACCOUNTANT during the past year and to our representatives in all the provinces who encouraged the preparation of feature articles and sent in provincial news for publication. May we add our thanks also to those who orally

and by letter expressed appreciation to your Committee of its work during the year.

W. J. Saunders,
Chairman.

Toronto,
28th June 1939.

PRESIDENT DALGLISH ATTENDS ANNUAL MEETING OF AMERICAN INSTITUTE

For the information of members, Mr. Kenneth W. Dalglish, President of The Dominion Association of Chartered Accountants, has sent the following report on his visit to the annual meeting of the American Institute of Accountants at San Francisco, 18th to 22nd September 1939.

In accordance with the resolution passed at the closing meeting of Council of The Dominion Association of Chartered Accountants, held at Saskatoon on August 24th, I attended the annual meeting of the American Institute of Accountants at San Francisco as the representative of our Association.

On Monday, September 18th, I was invited to attend the luncheon of the Californian Society of Certified Public Accountants as one of the head table guests and had an opportunity of conveying briefly to the members of that Society the best wishes of the Dominion Association.

At the opening session of the American Institute's Annual Meeting on Tuesday morning, September 19th, I was invited to the platform by the President, Mr. Clem W. Collins, and had the privilege of again conveying the best wishes of our members to the annual meeting of the American Institute. During the course of my remarks I paid tribute to Mr. Collins and the part which he had played at our annual meeting in Saskatoon and also to his kindness in addressing our members after that meeting in two Western cities. I made reference to our plans for holding the next annual meeting of our Association in Montreal in 1940 and expressed the hope that the American Institute would be able to have a representative with us again.

The Past President of the Mexican Institute of Certified Accountants, Señor Roberto Casas Alatriste, was also on the platform at the opening meeting and spoke on behalf of the accountants of Mexico.

At the closing banquet, held on Thursday, September 21st, I was also privileged to be seated at the head table. During the course of the banquet an address was given by Mr. Chester Rowell, editor and publicist of San Francisco, on the subject of "Your World Today."

Meeting and Roundtable Discussions—At the opening general session a great deal of discussion took place in connection with the report issued in May 1939 on "Extension of Auditing Procedure" which dealt particularly with inventories and receivables and which also contained a new form of auditors' report. At this meeting the special committee of the Institute dealing with these matters offered amendments to that report which had the endorsement of the Council of the Institute. In the May report observation of physical inventory taking or tests of physical inventories by the auditors were recommended as normal auditing procedure and in the event that it was impossible for the auditor to carry out this work it was necessary for him to make mention of the omission of such procedure in his report. One of the amendments to the report of the special committee made this disclaimer no longer necessary. However, the auditor would be expected to be in the position to be able to show that a satisfactory test of physical inventories was not possible. The other amendment dealt with the form of certificate or report. In the May report the expression "but we did not make a detailed audit of the transactions" and which had appeared for the last two or three years in the common form of report used by American accountants, was omitted. It was recommended by the special committee that this phrase be continued. During the discussion it was indicated that while in general the American Institute did not wish disclaimers of any kind in the reports of auditors, yet it was considered desirable to continue the use of the expression referred to for at least some years as a medium by which the public might be educated to the limitations of the work of auditors.

Accounting Research—Having regard to the attention of our Association to this subject, I attended a roundtable discussion led by Professor Sanders of Harvard University, who is the head of the Research Bureau of the American Institute of Accountants. I was very much impressed with the discussion of this important subject of accounting re-

search and with those who are actively engaged in this work and who, undoubtedly, are representative of the best and soundest thought in the accounting profession in the United States. I also attended the roundtable discussion on the subject of inventories, which had particular reference to the necessary procedures to be carried out by auditors to implement the extension of auditing procedure to which reference has already been made.

On Thursday afternoon I was present at a discussion led by P. W. Glover, New York, on "What is expected of an Independent Auditor?" and in which several speakers took part, giving the viewpoint of the investor, commercial banker, management, etc.

Several other roundtable discussions took place simultaneously and it was therefore not possible to attend them all. There would seem to be no doubt that these roundtable discussions occupy a very important place in the proceedings of the annual meeting and they have been well developed by the American Institute. It is to be hoped that this similar phase of our annual meeting will be continued.

Social—It is hardly necessary for me to make reference to the entertainment offered at the annual meeting which was varied and lavishly given. The members of the Council of the American Institute and others present at the meeting extended their hospitality to me in many directions.

It was also a great pleasure to me to meet some of our own members resident in California. Among these were Mr. F. G. Short of San Francisco, a member of the Ontario Institute, Mr. L. H. Taylor of Seattle, a member of the Quebec Institute, and Mr. J. Harvey, of Victoria, a member of the British Columbia Institute, who was also in San Francisco during the time of the Meeting.

K. W. DALGLISH.

Montreal,
3rd October 1939.

The Dominion Association of Chartered Accountants

Thirty-Seventh Annual Meeting, Saskatoon, August, 1939

Front Row: F. A. Nightingale, H. G. Norman, Mrs. Nightingale, Geo. R. Freeman, Miss Hodge, Clem W. Collins, Mrs. Freeman, W. E. Hodge, W. Stempel, Mrs. Stempel, F. Johnson, A. E. Cox, A. H. Carr, Geo. C. Rooke, J. G. Mundie.

Supplement to November 1939 issue—The Canadian Chartered Accountant

GENERAL NOTES

Matters of Interest to Members

The Executive Committee of the Dominion Association learned with regret of the resignation on 7th September of Lieut.-Colonel Alberta E. Nash, F.C.A., who at the annual meeting in Saskatoon was elected a member of the Executive Committee and Chairman of the Finance Committee. On the outbreak of war Colonel Nash entered upon full-time military service as A.A. and Q.M.G. of Military District No. 2.

The President announced on 2nd October that Council had duly elected Kris A. Mapp, F.C.A., Toronto, to fill the vacancy. Mr. Mapp is well known to the profession throughout Canada as Chairman of the Association's committee on uniform examinations and a standardized programme of education for the Provincial Institutes. Mr. Mapp is a Past President of the Institute of Chartered Accountants of Ontario and is also immediate Past President of the Canadian Society of Cost Accountants and Industrial Engineers.

Examinations

According to the timetable of the Intermediate and Final examinations of the Provincial Institutes, as announced by the Board of Examiners-in-Chief, this year's examinations will be written during the week of December 4th to 9th. The morning sessions are to be from 9 a.m. to 1 p.m. and the afternoon sessions from 2 p.m. to 6 p.m.

Monday, December 4th

Morning session— Final Accounting I — Accounting, including business investigations

Afternoon session—Intermediate Accounting I

Tuesday, December 5th

Morning session— Final Accounting II—Accounting, including costs, budgetary control and systematizing

Afternoon session—Intermediate Accounting II

Wednesday, December 6th

Morning session— Final Accounting III—Accounting, including consolidations, executorships and trusteeships.

Afternoon session—Intermediate Auditing I

Thursday, December 7th
Morning session— Final Accounting IV—Accounting, General
Afternoon session—Intermediate Auditing II

Friday, December 8th
Morning session— Final Auditing I

Saturday, December 9th
Morning session— Final Auditing II.

Chartered Accountants and the War

From time to time information is reaching the editorial committee from the secretaries of Provincial Institutes concerning members who are engaged in activities arising out of the participation of Canada in the War. Following is a memorandum of brief particulars received to date:

Lieut. W. J. Ayers, Toronto, is serving with the 15th Battery, Royal Canadian Artillery.

Lieut.-Colonel K. G. Blackader, Montreal, is Officer Commanding 1st Battalion Black Watch, Royal Highland Regiment of Canada, C.A.S.F.

J. R. Church, Toronto, has been appointed to the staff of the Foreign Exchange Control Board of Canada.

W. L. Gordon, Toronto, has been appointed to the staff of the Foreign Exchange Control Board of Canada.

Guy E. Hoult, Montreal, was authorized by the Department of the Secretary of State to inspect financial books and documents of a number of companies who were known to have had business dealings with Germany, and to investigate the financial transactions of such concerns and to report to the Government.

M. H. W. Mackenzie, Montreal, has been appointed to the staff of the Foreign Exchange Control Board of Canada.

Lieut. Malcolm McLeod, Montreal, has joined the Royal Highlanders, Internal Security Force.

Robert E. Miller, Montreal, is Second Lieutenant, 42nd Battalion, Black Watch (R.H.R.) of Canada.

Lieut.-Colonel A. E. Nash, Toronto, has been appointed A.A. & Q.M.G. of Military District No. 2.

Gordon W. Scott, Montreal, was appointed early in September by the Dominion Government as a joint director of the War Supply Board. The duties of this office included

the consolidating, as far as could be found practicable, of the work of the War Supply Board and of the Defence Purchasing Board and of any other department or branch of the Government in connection with the purchase or acquisition of munitions and war supplies.

Lieut.-Colonel P. F. Seymour, Montreal, is Officer Commanding 4th Divisional Signals, Royal Canadian Corps of Signals.

David Young, Montreal, has been appointed by the Dominion Government the custodian of enemy property.

Appeal in Pioneer Laundry Case

We learn on good authority that the appeal by Pioneer Laundry and Dry Cleaners Limited to the judicial committee of the Privy Council from the judgment of the Supreme Court of Canada has been allowed. At the time this month's issue was going to press the written judgment of the committee of the Privy Council had not come to hand, but we expect to be able to publish a summary of the judgment in our December issue. A reference to the judgment of the Supreme Court was made in the January 1939 issue of THE CANADIAN CHARTERED ACCOUNTANT.

PERSONALS

Messrs. Clive M. Benson and Merrick B. Davidson announce that T. D. Goord, A.C.A. (England), C.A. (Ontario), of London, England, has become associated in partnership with them, to carry on practice under the firm name of Benson, Goord & Davidson, Chartered Accountants, from their offices 701-3 Confederation Life Building, Toronto.

PROVINCIAL NEWS

ALBERTA

The annual meeting of the Calgary Chartered Accountants' Club was held on Thursday, 28th September, at the Renfrew Club at 12.15 noon. Mr. Kenneth C. Teare was elected President for the ensuing year, and Mr. J. Stuart Simpson, Vice-President, and Mr. David Barr as Secretary-Treasurer.

A bowling league will be arranged during the coming season, the arrangements of this being left in the hands of Mr. T. L. Wright.

Presentations were made to Mr. John H. Insley and Mr. Fred E. Maxie, both of whom were recently married.

The Club will continue to hold monthly meetings during the ensuing year.

BRITISH COLUMBIA

Monthly dinner and discussion meetings of the British Columbia Institute were resumed for the present winter season with a meeting in Vancouver on 3rd October 1939. Mr. J. Haydn Young, Vice-President, presided.

The programme of the meeting was the report of the delegates to the annual meeting of the Dominion Association at Saskatoon. The delegates reporting were: Messrs. W. G. Rowe, President of the British Columbia Institute, E. C. Mapson and V. R. Clerihue.

Mr. John Parton, F.C.A., of Winnipeg, and Mr. G. B. McCann, C.P.A., of New York, being in Vancouver at the time, attended as guests.

With the October issue of The Canadian Chartered Accountant and the 1939-40 Year Book of the Dominion Association already to hand, there is little new to be said on the proceedings at Saskatoon. However, in that connection, the meeting expressed its gratification of the results achieved by the Committee on Uniform Examinations and Standardized Syllabus of Instruction. Appreciation was also expressed of the progress of the work by the Committee on Terminology.

Considerable interesting discussion was entered into on the matter of the auditor's responsibility in the verification

of the balance sheet item of merchandise on hand. In this connection, the meeting was fortunate in having a member of the profession from the United States who gave something of the viewpoint in that country on this matter in the light of the American Institute's recent review of audit procedure. Mr. McCann observed that, in his opinion, the procedure outlined in that review was not new, but was what had been regarded for many years as good practice.

In concluding, the chairman thanked all who had contributed to the discussion and, in particular, the guests of the evening.

OBITUARY

The Late Keith B. Ewan

The Institute of Chartered Accountants of Nova Scotia regrets to announce the death at Windsor, Nova Scotia, on 29th September 1939, of Keith B. Ewan at the age of fifty-three years.

The late Mr. Ewan had been a member of the Nova Scotia Institute since 1924 and was highly regarded in the profession and in Windsor, where he resided. He had not been in good health for some time and his death at a comparatively early age is deeply regretted by his fellow members.

CORRESPONDENCE

The Editor,
The Canadian Chartered Accountant.

Dear Sir:

The Editorial Comment of the August issue includes a contributed portion with respect to the controversial subject "Depreciation Accounting and Retirement Accounting," with reference of course, to the depreciation procedure of public utilities.

This is a question which has caused unending discussion and argument for many years, and it may be anticipated that the present trend towards increased governmental supervision and standardization of accounting methods will result in this problem attracting even greater attention in the future. In view of the opposing viewpoints and lack of agreement which have characterized previous attempts at solution, it would seem desirable for the official organ of the Dominion Association to direct the attention of the profession to the matter in an endeavour to bring about a clarification of accounting opinion. This objective is desirable from several points of view, and consequently it is gratifying to see reference to the subject in the magazine, although it does seem somewhat regrettable that editorial comment on this complex topic should be of such an inadequate and incomplete nature.

The suitability of the retirement method of accounting is admittedly limited to utility accounting, and the subject, therefore, is one of merely academic interest to the majority of accountants. Nevertheless, it is a matter which has commanded the earnest consideration of the world's leading valuation engineers and utility accountants and, as such, is surely deserving of somewhat more than the unsupported assertion that it lacks precision, and its unwarranted identification with "the practice of creating retirement reserves by random transfers from surplus." There is a strong school of accounting thought which stoutly maintains that it is both impractical and unnecessary to attempt to apply straight-line depreciation accounting to continuous structures such as pole lines, cable conduits, right-of-way fencing, and the like, or to the millions of cross-arms, braces, crossties, lengths of rail or cable, track fastenings, cubic yards of ballast, etc. which constitute a large portion of the property investment of certain utilities. In view of the self-evident difficulties involved in accounting for the depreciation of assets of this nature, the editorial's unsubstantiated rejection of retirement accounting does not dispose of the problem very satisfactorily.

It is also noted that all methods of accounting other than "depreciation accounting" have been indiscriminately lumped under the generic title "retirement accounting," no distinction having been drawn between the latter and "replacement accounting" despite the fact that both in basic principles and accounting and economic results the differences are substantial. Use of the replacement method, which has been followed consistently in Great Britain and elsewhere in part of the utility field, has produced a much more conservative valuation of capital assets with correspondingly increased charges against operations, due to the long-term rising price trend which has prevailed. The replacement method provides for the *current cost* of renewals being charged to expenses, whereas the retirement method provides for the capitalization of renewals and the charging to expenses of the *original cost* of the property retired.

In the second paragraph, which briefly dismisses the economic aspects of the question, it is inferred without qualification that the depreciation method takes cognizance of the obsolescence factor, and that, therefore, "the consumers who benefit from a property pay for that property." However, depreciation rates frequently do not purport to make any allowance for obsolescene and, in fact, no less an authority than Saliers expresses the belief that "it is not only impossible but wholly undesirable to attempt to make allowance in the depreciation rate for either obsolescence or inadequacy." Incidentally, Saliers also subscribes to the theory that losses resulting from obsolescence constitute a part of the cost of replacement, properly chargeable against future consumers.

In consideration of the vast difference in the circumstances under which the American Telegraph and Telephone Company and "many railways and other kinds of utilities" have operated in the past decade, the comparison drawn between their respective financial conditions appears to be utterly lacking in significance, and it is most difficult to grant credence to the suggestion that the financial difficulties of the latter may be largely attributed to their depreciation policy. In this connection, mention might well have been made of the fact that depreciation accounting for equipment (which term includes all rolling stock) has been mandatory for all American railroads since 1907, and was widely practised prior to that date.

In conclusion, however, may I merely reiterate my regret that the editorial comment of the profession's official organ in Canada was not of a nature more in keeping with the importance and complexity of the subject, and express the hope that the Association may see fit to arrange for more comprehensive treatment in subsequent issues.

Montreal, Yours truly,
5th September 1939. J. C. Gilmer.

The Editor,
The Canadian Chartered Accountant.

Dear Sir:

I thank you for your courtesy in forwarding to me a copy of Mr. J. C. Gilmer's letter dated September 5th.

For the comment of which Mr. Gilmer complains I am, of course, solely and wholly responsible since it appeared in effect over my name. Whether or not the strictures contained in the second and last paragraphs of his letter are justified I must now leave for others to judge.

No one could regret more keenly than I that any contribution to The Canadian Chartered Accountant should be considered unworthy of that journal; I derive considerable satisfaction however from the circumstance that I elicited for the correspondence columns of the magazine so interesting a letter from one so widely experienced in public utility accounting.

Your very truly,
R. G. H. Smails.

Kingston,
19th October 1939.

BOOK REVIEWS

BREWERY ACCOUNTS

By G. S. Hamilton

(Published by *Gee and Company (Publishers) Limited,* London, 1939, cloth, 148 pp., 13s 1d postpaid)

This is an English book and it deals solely with the accounts and trading policies of brewing companies in the British Isles. This is a disadvantage from a Canadian point of view as the system of accounts described differs in many respects from that in general use by breweries on this continent.

The author's method of approaching the subject is to explain in detail all items on the financial statements before commencing a general discussion of the system and its problems. The explanations are clear and concise and can be easily followed by any accountant having a slight knowledge of brewery trade practice.

A considerable portion of the book is devoted to the discussion of owned and tied houses and the accounts to be kept in respect thereof. Much of the subject matter in these chapters is applicable only to England but is of considerable interest to anyone engaged in this class of business.

Excise and income tax requirements are responsible for many records not required here and trade policies peculiar to the British Isles cause other differences.

Only one chapter is devoted to costing. Apparently the author is of the opinion that it is not practical to prepare the financial accounts so as to interlock with the cost accounts, due possibly to the many outside activities carried on by the brewery under discussion.

In conclusion I might say that, from a comparative point of view, the book should be of interest to accountants engaged in brewery practice on this continent.

W. L. LUCAS.

Edmonton, 10th October 1939.

VACATIONS WITH PAY IN CANADIAN INDUSTRY

(Published as Bulletin No. 3 by *Industrial Relations Section, Queen's University,* Kingston, Ontario, 1939, paper, 90 pp., $1.00)

"Vacations with Pay in Canadian Industry" is the third bulletin issued by Queen's University's newly established Industrial Relations Section, headed by Professor J. C. Cameron. Like its predecessors, in its 82 pages and 20 tables, this bulletin contains a wealth of factual information. In interesting and convincing detail it deals with the gradual extension of paid vacations amongst hourly-paid as well as salaried employees, not only in Canada, but abroad. The book offers conveniently compiled data for use by any employer who wishes to ascertain what others are doing in the field of vacations.

The study is based upon information supplied by 490 parent and subsidiary companies, covering approximately 6,200 separate establishments, in the fields of manufacture, wholesale and retail trade, public utilities, finance and transportation. It provides statistics in connection with paid vacations of some 400,000 out of a total of 2,570,000 persons who are employed by others in Canada. The information was

secured by means of a comprehensive questionnaire sent to 1,000 companies, large and small in all provinces of Canada, and representative of all important Canadian industries other than agriculrure. The questionnaire is reproduced in an appendix to Mr. Cameron's book as is also the list of names of the companies which supplied the information.

The one deficiency in the study seems to us to lie in the fact that only those companies were included which already grant vacations with pay to at least some of their employees. The study consequently cannot provide any estimate of the total number of Canadians receiving paid vacations. Of the reporting companies, however, 213,000 persons, or 54% of the total, received vacations with pay. This percentage would presumably be considerably higher than that for all employed Canadians. Mr. Cameron expresses the opinion that in paying for vacations Canada is considerably behind Britain, United States and certain continental countries, in certain of which, as in France, Germany, and Russia, national legislation has been enacted requiring that every employee should receive at least a minimum number of days of paid vacation annually.

"A large section of Mr. Cameron's book deals with the vacation practice of Canadian employers. As might be expected, executives and office workers are treated in the matter of vacations more liberally than are employees engaged in production, particularly when paid on an hourly basis. He points out, however, that the granting of paid vacations to hourly-paid workers has become much more common in Canada during the past five years, partly on account of pressure from labour unions but to a much greater extent because employers are coming to realize that the granting of vacations is in itself a good investment, which not only makes for greater harmony between employers and employees, but also increases workers' efficiency. One company, according to Mr. Cameron, described a paid vacation plan for wage earners as "a necessity that pays for itself."

In his conclusion, Mr. Cameron ventures an opinion as to the trends likely to appear in the provisions of company vacation plans. He lists these trends under twenty-four headings, and as these summarize in a simple and practical form the result of Mr. Cameron's protracted study of the case, we take the liberty of quoting from them *in extenso:*

1. All permanent employees are likely to be included in the plan. Some provision may be made for temporary employees.
2. Provision is likely to be made for including categories of employees such as salesmen and agents on commission, service station attendants in leased station, etc.
3. The vacation period may either be fixed in length or may increase with length of service. Vacations of fixed length now predominate and are usually one week for wage earners and two weeks for salaried employees.
4. Two weeks' vacation will probably be increasingly provided for wage earners . . . .
5. The periods of long service required for the extra vacations will probably be gradually reduced . . . .
6. The period of preliminary service required for eligibility is likely to be reduced. One year will probably become the standard.
7. Regulations governing continuous service may become less rigid.
8. Vacations of less than the standard period are likely to be provided for employees who have been in the service of the company for a shorter time than the required service period . . . .

9. Special conditions requiring attendance, punctuality, etc., are never likely to be important.
10. No distinctions in the length of the vacation period are likely to be made between male and female employees.
11. Uniform provisions are to be expected throughout all the units of a company.
12. Distinctions between categories of employees—executives, office salaried, plant salaried, wage earners—may continue, but there seems to be a definite trend towards uniformity, at least within the salaried group and the wage earning group, and sometimes even among all employees.
13. Full pay is likely to be the standard vacation allowance.
14. The pay may be calculated by multiplying the hourly rate by either standard hours or hours normally worked. For piece workers some form of averaging earnings is common. The standard week used is tending towards forty-four hours.
15. The time of vacation as far as possible is likely to be arranged in the summer. As the movement spreads into manufacturing industries shutdown plans may become more common. In other cases any extension of the coverage will make vacation schedules more difficult to arrange, and it may be necessary to provide inducements to take vacations in off seasons.
16. Seniority is likely to be the chief ground for preference influencing the arrangement of the vacation schedule. Married employees may be given some preference.
17. Accumulation of vacations from year to year will probably not be permitted.
18. Employees will, in general, probably be required to take the whole of their vacation period at one time, although as the vacation period becomes longer division may be permitted.
19. Extensions of the paid vacation period because of illness or other reasons may be permitted more frequently in future.
20. Reductions in the period of paid vacation because of absence, illness or other reasons are likely to be infrequent.
21. The vacation allowance in the majority of cases will be paid before the vacation . . . .
22. The granting of an additional day of vacation when a legal holiday happens to fall within the vacation period is likely to become general for salaried employees, but for wage earners will have to await a movement towards payment for legal holidays.
23. Payment of wage earners for legal holidays may gradually become more common . . . .
24. As paid vacations come to be more and more recognized as a part of the terms of employment, employees leaving the service of the company before the vacation season will probably be granted an allowance in proportion to the vacation period which their service has already earned.

Whether these "24 points" may rightly be considered as the sign marks of the road vacation policies are likely to travel in Canada, or whether they should be regarded as reasonable objectives to be obtained by wage earners, they are of equal interest to employers and to labour leaders alike. They appear to offer a comprehensive yet conservative programme which should shortly be within reach of most, if not all, employees in Canadian industrial and commercial occupations.

Toronto, 13th September 1939. J. S. Willis.

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding, too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(Continued from August issue)

Salary: The periodical compensation, usually fixed in amount, paid to employees holding managerial, professional, administrative or clerical positions, as distinguished from that paid for manual labour or mechanical work, and which is known as "wages." Although not entirely so, the distinction in the terms is largely an accounting technicality, and has its particular usefulness in that connection. The periodical list of salaries in a business is known as the "Salary Roll."

Sale or Return: A term used when commodities are delivered to a customer without a sale being effected at the time, with a condition that the customer may return within a specified time if he decides not to buy; "sale on approval" is a synonymous term.

Sales: The exchange of commodities in the ordinary course of business for money or other valuable consideration expressed in terms of money. In accounting the word "sales" should only be used in connection with the commodities produced or sold as the business of the enterprise. Thus, fixed assets may from time to time be disposed of, but the consideration therefor should not be included in the total of "sales" as shown in the accounts. "Barter" is a method of exchanging commodities direct without consideration in money values; this is merely mentioned here, as in accounting such a transaction would have to be reduced to money values in almost all cases for the purpose of record.

Sales Records: Those which appertain to goods sold. The old "Sales Journal," which originally consisted of copies of invoices for sales written into a bound book, has now largely been superseded by carbon or other copies of invoices the totals of which are carried to a "Recapitulation" sheet in

columnar form, separated if desirable into classifications according to departments or lines of merchandise. Totals are posted to "Sales Account" in the ledger, which thus records the total business by periods. Other sales records consist of original orders, tickets, warehouse books, customers' ledgers, etc.

Salvage Value: That which may be realized for assets which have been rendered ineffective for their regular use or saleability by fire, accident or other damage.

Schedule: According to *The Concise Oxford Dictionary,* "a tabulated statement of details, inventory, list, etc. especially as appendix or annexe to principal document." Thus, it will refer to such lists as may accompany a balance sheet; but it is submitted that any appendices such as profit and loss account, surplus account, etc., being accounts in reality however they may be condensed, should be called "accounts" or "statements," and not schedules.

Scrap Value: The value which remains and can be realized in an asset the functional usefulness of which has ceased to exist, whether by wear and tear, obsolescence or any other cause.

Scrip: Provisional certificates of shares, bonds, or other securities issued pending preparation of formal certificates or payment in full on instalment issues.

Seal: (of Company or Corporation): An instrument which impresses on formal documents the device adopted by the company as its official "signature"; the device so impressed. Under most Companies Acts the seal must bear the name of the company and often the year of incorporation. While, without other regulations, it actually is the "signature" of the company, it is usually provided by by-law or otherwise that it must be attested by the written signatures of at least two named officers.

Seal Register: A record of documents on which the company's seal has been impressed.

Secondary Liability: That of a party who becomes responsible for a debt on the failure of the primary debtor to discharge it; e.g., the endorser of a note or cheque, the drawer of an acceptance, a guarantor or surety, etc.

Secret Reserve: One which is not connected with any particular account, but which, by the omission or undervaluation of certain assets, or by the overstatement of li-

abilities, is a general understatement of the net worth of a company.

Secured Account: One wherein the debtor has handed to or otherwise pledged to the creditor certain assets or guarantees as a consideration for the granting of credit or an extension thereof.

Security: That which is hypothecated as a pledge for fulfilment of an obligation or debt, e.g., the land in the case of a mortgage; land, buildings and plant in the case of bonds; accounts receivable and stock in trade for a bank loan, etc. Stocks and bonds are also colloquially referred to as "securities."

Selling Cost: The cost of selling, as contrasted with manufacturing cost. It includes advertising, salesmen's salaries and expenses, commissions, sale office expenses, etc.

Selling Expense: Any expense included in the general heading of Selling Cost.

Serial Bonds: Bonds issued on terms of annual or other periodical repayments of principal with interest, such payments together equalling a constant amount.

Shares: The units into which the capital of an incorporated company is divided. They may be of various classes, e.g., Preference, having a right to certain dividends in priority to Common, which in turn are entitled to dividends from the remaining profits. These two classes, however, may in turn be subdivided into different ranks of priority. See "Common Stock," "Preferred (or Preference) Capital," "Cumulative Preferred Capital," "Participating Capital."

Share Capital: The capital of a company as represented by shares of capital stock, as distinguished from loan capital represented by bonds, or accumulations of undivided profits shown as surplus.

Shareholder: A holder of a share or shares in a company.

Share Ledger: The book or other register required under the Companies Acts to record the holdings of individual shareholders.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

So far as we are aware, no general companies act in this or any other country has made express reference to secret reserves or given any guidance to auditors in the matter of the creation or utilization of such reserves. Two sections of *The* [Dominion] *Companies Act, 1934* do however bear indirectly on the subject. One is Section 112(1) which requires directors to lay before the company "a statement of surplus showing separate amounts for capital surplus, distributable surplus and earned surplus respectively, the amounts of such surpluses respectively at the beginning of the financial period, adjustments affecting previous financial periods . . ." etc. From the date (1934) when this provision was written into the Dominion act it may be inferred that the legislature was conscious of the recent exposures in the *Royal Mail Steam Packet Company* case and that it was attempting to preclude the concealed utilization of secret reserves to bolster steadily deteriorating operating results.

The other section of the 1934 Act which has an indirect relation to the subject of secret reserves is Section 114(3) which requires the auditors to state in their report on the balance sheet of a holding company the amount by which in their opinion "the amounts treated as income received or receivable from [non-consolidated] subsidiaries for the purposes of the income and expenditure statement of the holding company, in the opinion of the said auditors, exceed the profits of the subsidiary or, if more than one, the combined aggregate of profits less losses of all subsidiaries." This provision would seem negatively (and has been interpreted by the profession) to condone the creation of secret reserves in a holding company by the understatement of profits of subsidiaries since it relieves the holding company and its auditor from giving information as to the amount of such understatement. Thus typically we find auditors reporting that "the profits for the year ending . . . of the wholly owned subsidiaries of your company were in excess of the dividends paid by them and treated as income in the profit and loss account of your company."

An undertaking to publish quarterly earnings statements is now required by the New York Stock Exchange from any company (not previously listed) which desires to have its securities listed on the Exchange but the requirement does not extend formally to companies whose securities were already listed before the requirement was formulated. Nevertheless a recent report by the Exchange[1] discloses that of the now listed active domestic companies 73 per cent, issue income statements at quarterly intervals or more frequently, 15 per cent. announce the financial results of their operations semi-annually, and only 12 per cent. restrict their stockholders to an annual report of earnings. A number of these latter companies which publish earnings only once a year make a practice of releasing statistical data monthly or quarterly showing sales or volume of business. Only one tenth of them actually confine their information to yearly statements.

This is a very different situation from that prevailing just after the Civil War when the Exchange was advised by a well-known company, in answer to its request for a financial report, that it "made no reports and published no statements and had not done anything of the kind for the past five years." It is also markedly different from the situation which existed so recently as 1926 when of 957 listed active domestic companies only 25 per cent. were under agreement to publish earnings at quarterly intervals and 8 per cent. were under agreement to publish semi-annual statements.

At present about one hundred listed active domestic corporations publish no interim financial information. "Notwithstanding certain recognized objections The Committee [on Stock List] is not convinced that most of these companies could not adopt the generally accepted practice of publishing interim financial information. Many of these companies are engaged in similar lines of business as, and are otherwise comparable to, other listed companies which now publish quarterly reports. On the other hand, some of the companies are engaged in lines of business where the publication of quarterly earnings statements is meaningless or deceptive because of inherent difficulties in apply-

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[1]*New York Stock Exchange Bulletin*, Vol. X, No. 8, August 1939.

ing conventional accounting principles to allocate their earnings to short periods of time."[2]

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[2]Opus cit. p. 4.

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STUDENT ASSOCIATION NOTES

ONTARIO—Toronto

Our enthusiastic reports of the spring athletic activities of the Student Association led the editor of this magazine to the conclusion that we "revel and excel in tennis, base-ball and golf during the summer months and in nothing in particular during the winter months." It does appear, indeed, that the students agree with Milton, who says in his "Areopagitica," that "in those vernal seasons of the year, when the air is calm and pleasant, it were an injury and sulleness against nature not to go out and see her riches and partake in her rejoicing with heaven and earth." He says, further, that he "should not be a persuader to them of studying much then, after two or three years that they have well laid their grounds . . ."

We hasten to dispel any false impression by giving here a report of academic (winter) activities, which began at the beginning of October. Due to the success of the group meetings held in the spring it was felt that they should be continued, and primary, intermediate and senior groups have been meeting every week.

On September 18th Mr. Holland Pettit, Jr., C.A., discussed the Toronto Stock Exchange audit with senior students, and on the 28th this group heard Mr. J. F. Gibson, F.C.A., of the Federal Income Tax Department speak on "Company Income Tax." At the third meeting Mr. M. W. Waddington, C.A., discussed Public Utilities Accounting Problems. As in the spring, the intermediate groups were held under the leadership of Mr. K. E. Greenwood, C.A., who gave two talks on "Capital and Surplus," and two on "Consolidations." We prefer to speak here of "talks" rather than "lectures" or "addresses" since the meetings are essentially informal discussion groups.

Primary students began their meetings with a second discussion of problems in arithmetic under the leadership of Mr. A. R. McMichael, F.C.A., and at the following meeting Mr. C. E. Baker, C.A., gave an outline of general ac-

counting principles, stressing in particular partnership agreements. "Operating Statements and Balance Sheets" was the subject for discussion at the third meeting and the speaker was Professor W. S. Ferguson of the Accounting Department of the University of Toronto.

Further group meetings will be held until shortly before the examinations, and the final meeting will probably take the form of a law lecture.

On Thursday, October 5th, a most successful informal dinner was held at the University Club, and over 90 students were present. On this occasion members of the Accounting Staffs of the University of Toronto and Queen's University and many Chartered Accountants were the guests of the students. Much of the success of the dinner was due to the congenial atmosphere of the club and to the excellence of the arrangements there. Entertainment—of a light and informal nature, vocal and otherwise—was provided by a group of students, and there were two addresses of a decidedly serious nature and of immediate interest to the students.

The first was a discussion by Mr. Kris A. Mapp, F.C.A., of the new curriculum, which clarified a matter of no small concern; and the second address was given by Mr. Nicholas Ignatieff on the subject "Where does Russia stand?" Mr. Ignatieff's authoritative analysis of the situation was greatly appreciated at this time, and brought to a close one of the Association's most successful meetings.

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QUEBEC

The formal Programme of Activities, Fall Season, 1939 is as follows:

Lectures on Old Examination Papers

A series of lectures on questions taken from examination papers of previous years.

Final Examinations

Sept. 29	C. N. Knowles, C.A.	Examination Writing Technique
Oct. 6	P. K. Nutt, C.A.	Comparative Statements
Oct. 13	T. V. Burke, C.A.	Auditing and Investigations
Oct. 20	Col. P. F. Seymour, C.A.	Consolidations
Oct. 27	A. W. Gilmour, C.A.	Income Tax
Nov. 3	G. M. Smith, C.A.	Cost Accounting

Intermediate Examinations

Nov.	10	J. G. Hutchison	Accounting
Nov.	17	J. G. Hutchison	Auditing

Chartered Accountants' Groups

Members will be informed of the formation of groups for the study of such subjects as the interest of the members determines.

Lectures for French Students

Lectures will be held on Wednesday evenings at 8 p.m. under the supervision of André G. Leroux, C.A.

The annual Smoker will be held on the Friday evening following the Final Examinations.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by a practising chartered accountant of the Institute from whose examinations the problem is taken and represent his views and opinions. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE INSTITUTES OF CHARTERED ACCOUNTANTS OF ALBERTA AND ONTARIO

INTERMEDIATE EXAMINATIONS, DECEMBER 1938

AUDITING No. 1

Question 1

The following Balance Sheet and related statement of Profit and Loss of The London Printing Co., Ltd. as at 30th September 1938, are handed to you as the duly appointed auditor of the company, for your approval:

Balance Sheet

LIABILITIES		
Mortgage Payable	$215,000.00	
Reserves	510,000.00	
Surplus	205,000.00	
Capital Stock	600,000.00	
Accounts Payable	35,000.00	
Accrued Liabilities	5,000.00	
		$1,570,000.00
ASSETS		
Deferred Charges	$ 5,000.00	
Land and Buildings	400,000.00	
Plant	830,000.00	
Investments	55,000.00	
Inventories	160,000.00	
Accounts Receivable	117,000.00	
Bank balance	3,000.00	
		$1,570,000.00

Profit and Loss Statement
for the year ended 30th September 1938

Sales of Printing	$860,000.00	
Building rentals charged tenants	6,000.00	
Building rentals charged to business	25,000.00	
Income from Investments	2,500.00	
		$ 893,500.00
Printing Cost and Expenses	$720,000.00	
Depreciation of Building and Plant	62,000.00	
Building Expenses	19,000.00	
Mortgage Interest paid	9,000.00	
Income Tax provision	11,000.00	
		821,000.00
Profit		$ 72,500.00

During the course of your examination, the following information, pertaining to the figures given to you, is disclosed:

(1) The following items make up the total amount shown for Reserves:

Provisions for Income Taxes	$ 16,000.00
Reserve for revaluation of inventories due to a decrease in market value	15,000.00
Provision for pensions	5,000.00
Reserve for depreciation of building	55,000.00
Reserve for depreciation of plant	400,000.00
Reserve for bad debts	11,500.00
Provision for loss on customers' paper under discount at the bank amounting to $25,000.00	7,500.00
	$510,000.00

(2) Surplus includes the following balances:

Accumulated income from printing operations	$ 30,000.00
Balance of Profits from sale of investments (after charging up a loss of $3,500.00 on securities sold July 2, 1938)	5,000.00
Part of proceeds from sale of no par common shares set aside as distributable surplus	170,000.00
	$205,000.00

(3) Particulars of Capital Stock:

Preferred 6% redeemable par value $100.00	
Authorized and issued 10,000 shares	
Previously redeemed 9,000 shares	$100,000.00
Common—no par value	
Authorized 100,000 shares	
Issued 69,000 shares of which a subscription for 2,000 shares at $10.00 per share is unpaid. Amount paid in and credited to Capital Stock Account	500,000.00
	$600,000.00

(4) Land and Building is made up of:

Land	$ 30,000.00
Building	260,000.00
Vacant Land	110,000.00
	$400,000.00

(5) Accounts Receivable includes $5,000.00 advanced to a shareholder and $12,000.00 advanced to a paper supplier against future deliveries of paper.
(6) Accounts Payable includes $5,000.00 advanced by a customer for work not yet delivered.
(7) Dividends were paid during the period under review amounting to $59,600.00.
(8) Building Expenses include payment of $3,000.00 taxes on the vacant property.
(9) Depreciation of Building and Plant is made up as follows:

Depreciation of Building	$ 6,500.00
Depreciation of Plant	55,500.00
	$62,000.00

Redraft the Balance Sheet and Profit and Loss Statement and write up Surplus Accounts in the form you would consider to be in accordance with the best practice. Give, where you consider it necessary, reasons for your treatment of the various items which necessitate changes in the statements submitted to you.

SOLUTION

THE LONDON PRINTING CO., LTD.
BALANCE SHEET
as at 30th September 1938

Assets

Current Assets			
Bank balance		$ 3,000.00	
Accounts Receivable	$100,000.00		
Less Reserve for Bad Debts	11,500.00	88,500.00	
Advance to Shareholder		5,000.00	
Inventories	160,000.00		
Less Reserve to reduce to market Value	15,000.00		
		145,000.00	
Advances against future deliveries of paper		12,000.00	
Investments		55,000.00	
			$ 308,500.00
Fixed Assets			
Land		30,000.00	
Building	260,000.00		
Less Reserve for Depreciation	55,000.00		
		205,000.00	
Plant	830,000.00		
Less Reserve for Depreciation	400,000.00		
		430,000.00	
Vacant land		110,000.00	
			775,000.00
Deferred Charges			5,000.00
			$1,088,500.00

Liabilities

Current Liabilities			
Accounts Payable		$ 30,000.00	
Accrued Liabilities		5,000.00	
Advance by Customer for work not delivered		5,000.00	
Income taxes—provision		16,000.00	
Provision for Pensions		5,000.00	
Reserve for Customers' paper under discount		7,500.00	
			$ 68,500.00
Mortgage Payable			215,000.00
Capital and Surplus			
Capital Stock			
Preferred 6% redeemable par value $100 a share			
Authorized and issued	10,000 shares		
Less Shares redeemed	9,000 shares		
Outstanding	1,000 shares	100,000.00	
Common—no par value			
Authorized	100,000 shares		
Issued and fully paid	67,000 shares	500,000.00	
Issued and unpaid	2,000 shares		
(Subscription price $20,000.00)			
Surplus			
Distributable Surplus	$170,000.00		
Earned Surplus			
From Printing Operations..	30,000.00		
From Sale of Investments..	5,000.00		
		205,000.00	
			805,000.00
			$1,088,500.00

NOTE: There is a contingent liability amounting to $17,500.00 in respect of customers' paper under discount at the bank.

THE LONDON PRINTING CO. LTD.

TRADING STATEMENT

for the year ended 30th September 1938

Sales of Printing		$860,000.00
Printing Cost and Expenses	$720,000.00	
Depreciation of Plant	55,500.00	
		775,500.00
Trading Profit		$ 84,500.00

STATEMENT OF REVENUES AND EXPENSES—BUILDING

for the year ended 30th September 1938

Revenues		
Rentals charged to Business	$ 25,000.00	
Rentals charged to Tenants	6,000.00	
		$ 31,000.00
Expenses		
Building Expenses	16,000.00	
Depreciation	6,500.00	
		22,500.00
Net Revenues—Building		$ 8,500.00

STATEMENT OF PROFIT AND LOSS
for the year ended 30th September 1938

Trading Profit	$ 84,500.00	
Net Revenues—Building	8,500.00	
Income from investments	2,500.00	
		$ 95,500.00
Mortgage interest paid	9,000.00	
Taxes on vacant land	3,000.00	
Income tax provision	11,000.00	
		23,000.00
Net Profit		$ 72,500.00

STATEMENT OF SURPLUS EARNED FROM PRINTING OPERATIONS
for the year ended 30th September 1938

October 1, 1937	Balance forward	$ 17,100.00
September 30, 1938	Net profit for the year endeded Sept. 30/38	72,500.00
		$ 89,600.00
	Dividends paid	59,600.00
September 30, 1938	Balance forward	$ 30,000.00

STATEMENT OF SURPLUS EARNED FROM SALE OF INVESTMENTS
for the year ended 30th September 1938.

October	1, 1937	Balance forward	$8,500.00
July	2, 1938	Loss on securities sold	5,000.00
September	30, 1938	Balance forward	$3,500.00

NOTES: The Investments are shown as Current Assets assuming that they are available for immediate conversion into cash if needed.

Mortgage interest is shown as a charge in the Profit and Loss Statement instead of the Building Revenues and Expenses Statement on the assumption that the proceeds of the Mortgage payable were used for general financing of the business.

PROBLEM II
THE INSTITUTES OF CHARTERED ACCOUNTANTS OF ALBERTA AND ONTARIO
FINAL EXAMINATIONS, DECEMBER 1938
ACCOUNTING No. 1
Question 1

The following Trial Balances as of 31st December 1937, have been taken from the books of "A" and "B" Companies, which were both incorporated under Dominion Charters.

"A"

	Dr.	Cr.
Factory Land and sites for Workmen's Houses	$ 110,000.00	
Factory Buildings and Workmen's Houses	450,000.00	
Machinery and Equipment	800,000.00	
Furniture and Fixtures	30,000.00	
Autos and Trucks	20,000.00	

Reserves for Depreciation:				
Factory Buildings and Workmen's Houses				$ 112,000.00
Machinery and Equipment				500,000.00
Furniture and Fixtures				15,000.00
Autos and Trucks				10,000.00
Investment in "B" Company			900,000.00	
Representing:				
3,000 Preferred Shares in "B" Company		$300,000.00		
4,000 Common Shares in "B" Company		400,000.00		
Surplus of "B" Company as of of 31st December 1933	$250,000.00			
Deduct: Losses of "B" Company from 1st January 1934 to 31st December 1936, written off to Earned Surplus A/c in "A" Company's books	50,000.00			
		200,000.00		
Cash in banks and on hand			517,000.00	
Investment in bonds and stocks			300,000.00	
Reserve for depreciation of marketable securities				70,000.00
Accounts Receivable			400,000.00	
Reserve for Doubtful Accounts				30,000.00
Inventories 31st December 1936			700,000.00	
Goodwill			1,000.00	
Issued Share Capital:				
20,000 5% Cum. Redeemable Preferred Shares of $100.00 par value				2,000.000.00
1,000 5% Cum. Preferred Stock redeemed			100,000.00	
Common Shares, No Par Value				
20,000 Class A } 100,000 Class B }				1,000,000.00
Accounts Payable				70,000.00
Accounts Payable—"B" Company				300,000.00
Reserve for containers in hands of customers				30,000.00
Earned Surplus, 31st December 1936				387,000.00
Purchases			3,000.000.00	
Operating expenses			700,000.00	
Factory Insurance			4,000.00	
Municipal Taxes			15,000.00	
Advertising and Selling expenses			100,000.00	
Salaries of Executive Directors			60,000.00	

Directors' Fees	2,000.00	
Directors' travelling expenses	1,000.00	
Directors' Executive Committee fees	2,000.00	
Legal expenses	1,000.00	
Administration and Head Office expense	30,000.00	
Exchange on purchases	2,000.00	
Group Insurance	1,000.00	
Discounts, net	17,000.00	
Credit Insurance	1,000.00	
Provincial Capital and Office Taxes	5,000.00	
Profit on Autos and Trucks sold		1,000.00
Rents from Workmen's Houses		5,000.00
Repairs, Municipal Taxes and maintenance of Workmen's Houses	2,000.00	
Commissions received		10,000.00
Dividends from investments		5,000.00
Bond Interest		3,000.00
Dividends from Subsidiary "B" Company on 3,000 Preferred Shares		60,000.00
4,000 Common Shares		60,000.00
Trade and Bank Interest		2,000.00
Dividends on Preferred Stock (10% on account of arrears)	190,000.00	
Dominion and Provincial Income Tax adjustments, years 1935 and 1936	10,000.00	
Sales		4,000,000.00
Outward Freight	100,000.00	
Exchange on sales	1,000.00	
Depreciation provisions for year 1937		
Buildings and Workmen's Houses	11,000.00	
Machinery and Equipment	80,000.00	
Furniture and Fixtures	3,000.00	
Autos and Trucks	4,000.00	
	$8,670,000.00	$8,670,000.00

"B"

	Dr.	Cr.
Factory Land	$ 10,000.00	
Factory Buildings	100,000.00	
Furniture and Fixtures	10,000.00	
Reserves for Depreciation:		
Factory Buildings		$ 15,000.00
Furniture and Fixtures		2,000.00
Cash in banks	20,000.00	
Investments in bonds and stocks	280,000.00	
Investment—1,000 Preferred Shares in "A" Company	100,000.00	
Reserve for depreciation of marketable securities		8,000.00
Accounts Receivable	5,000.00	
Administration and Head Office expense	3,000.00	
Commissions received		15,000.00
Dividends from investments		1,000.00
Bond interest		1,000.00
Dividends from Preferred Shares in "A" Company		10,000.00

Dominion and Provincial Income tax adjustments for years 1935 and 1936		1,000.00	
Accounts Receivable from "A" Company .		300,000.00	
3,000 5% Cum. Pfd. shares $100 par value			300,000.00
4,000 Common Shares $100 par value ...			400,000.00
Earned Surplus as of 31st December 1933	$250,000.00		
Less: Subsequent losses from 1st January 1934 to 31st December 1936	50,000.00		
			200,000.00
Dividends on 3,000 5% Pfd.		60,000.00	
Dividends on 4,000 Common		60,000.00	
Depreciation provision for year 1937			
Buildings		2,000.00	
Furniture and Fixtures		1,000.00	
		$ 952,000.00	$ 952,000.00

The closing inventory for "A" Company as at 31st December 1937 as certified to by officials of the company, on the basis of the lower of cost or market value, was $1,222,000.00. Salaried directors do not participate in directors' fees or directors' executive committee fees.

After ascertaining the taxable profits for the year 1937 for each of the two companies, make provision for Dominion Income Tax only, at the rate of 15%.

Apply the dividend received by "A" Company, from "B" Company, during the year 1937 of $60,000.00 on Preferred Shares, and $60,000.00 on Common Shares in the reduction of "A" Company's investment in "B" Company of $900,000.00 (representing the total issued shares of "B" Company of $700,000.00, plus the Surplus of $250,000.00 in "B" Company's books, as at 31st December 1933, the date when "A" Company made this investment in "B" Company, less the $50,000.00 representing subsequent losses by "B" Company).

The arrears on the 5% Cum. Preferred Shares of "A" Company as at 31st December 1937 were $190,000.00.

The market value of the combined marketable securities at the close of the fiscal year was $575,000.00.

Prepare for submission to the shareholders of "A" Company the consolidated balance sheet of "A" and "B" companies, consolidated statement of Earned Surplus and consolidated Income and Expenditure account for the year ended 31st December 1937. (Abbreviate the consolidated Income and Expenditure Account in such manner as to show separately only those items required under the Dominion Companies Act.)

In preparing the above Consolidated Balance Sheet, omit any reference to the Authorized Share Capital.

Show the Combined Fixed Assets, which represent cost, as one item and the Combined Reserves for Depreciation as one item.

SOLUTION

"A" COMPANY LIMITED AND SUBSIDIARY "B" COMPANY LIMITED

CONSOLIDATED BALANCE SHEET
AS ON 31st DECEMBER 1937

ASSETS

Fixed Assets		
Land, Buildings, Plant, Machinery and Equipment, at cost	$1,530,000.00	
Less: Reserves for Depreciation	654,000.00	$ 876,000.00
Current Assets		
Cash in Banks and on hand	$ 537,000.00	
Marketable Securities, less Reserves (Market value $575,000.00)	502,000.00	
Accounts Receivable, after making provision for all doubtful accounts	375,000.00	
Inventories, as certified to by Officials of the Company, on the basis of the lower of cost or market value	1,222,000.00	2,636,000.00
Goodwill		1,000.00
		$3,513,000.00

LIABILITIES

SHARE CAPITAL		
Issued:		
20,000 5% Cum. Redeemable Preferred Shares of $100.00 par value	$2,000,000.00	
Less: 1,000 do Redeemed	100,000.00	
19,000	$1,900,000.00	
Less. 1,000 do Held by "B" Company	100,000.00	
18,000	$1,800,000.00	
(Memo: Arrears of Preferred Dividends $190,000.00)		
20,000 Class "A" Common No Par Value; 100,000 Class "B" Common No Par Value	1,000,000.00	$2,800,000.00
Current Liabilities		
Accounts Payable	$ 70,000.00	
Provisions for Dominion Income Taxes	61,650.00	131,650.00
Reserve for Containers in Customers' hands		30,000.00
Earned Surplus		551,350.00
		$3,513,000.00

COMBINED SURPLUS ACCOUNT
AS ON 31st DECEMBER 1937

Earned Surplus—1st January 1937			$ 387,000.00
Profit from Operations for year 1937, before making undermentioned deductions		$ 572,000.00	
Add: Investment Income		10,000.00	
Profit on sale of Autos and Truck		1,000.00	
		$583,000.00	
Deduct:			
Provision for Depreciation	$ 101,000.00		
Executive Remuneration and Legal Fees	63,000.00		
Directors' Fees	2,000.00	166,000.00	
		$ 417,000.00	
Income Tax adjustments for prior years	$ 11,000.00		
Provision for Dominion Income Tax for year 1937	61,650.00	72,650.00	344,350.00
			$731,350.00
Deduct: 10% Dividend paid on account of arrears on Preferred Share Capital		$ 190,000.00	
Less: Received by Subsidiary "B" Company		10,000.00	180,000.00
Earned Surplus—31st December 1937			$ 551,350.00